MALAYSIA ECONOMIC MONITOR

FEBRUARY 2023

Expanding Malaysia's Digital Frontier

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The MEM consists of two parts. Part 1 presents a review of recent economic developments and a macroeconomic outlook. Part 2 focuses on a selected special topic that is key to Malaysia's medium-term development prospects and to the achievement of shared prosperity.

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Abbreviations

AKPK	*Agensi Kaunseling dan Pengurusan Kredit*
ALMP	Active Labor Market Policies
ASEAN	Association of Southeast Asian Nations
B40	Bottom 40 percent (of the population)
BIMP-EAGA	Brunei–Indonesia–Malaysia–Philippines East ASEAN Growth Area
BKM	*Bantuan Keluarga Malaysia*
BNM	Bank Negara Malaysia
BPS	Business Pulse Survey
BTA	1970 Border Trade Agreement
CIT	Corporate Income Tax
COL	Critical Occupations List
COVID-19	Coronavirus Disease 2019
CPI	Consumer Price Index
DANJ	Dasar Agrikultur Negeri Johor
DGCCR	Digital Government Competency and Capability Readiness
DE	Development Expenditure
DOSM	Department of Statistics Malaysia
DRZ	Drones and Robotics Zone
E2E	End-to-end
E&E	Electricals and Electronics
EAP	East Asia and Pacific
ECRL	East Coast Rail Link
EIU	Economist Intelligence Unit
EMDEs	Emerging Market and Developing Economies
EPF	Employees Provident Fund
eKYB	Electronic Know Your Business
eKYC	Electronic Know Your Customer
FRA	Fiscal Responsibility Act
FSP	Financial Services Provider
GDP	Gross Domestic Product
GDPR	General Data Protection Regulation
GFCF	Gross Fixed Capital Formation
GNI	Gross National Income
GSB	Government Service Bus
HiFy	High-Frequency Phone Survey
IFS	International Financial Statistics
ILMIA	Institute for Labour Market Information and Analysis (ILMIA)
IMF	International Monetary Fund
LRT	Light Rail Transit
MCMC	Malaysian Communications and Multimedia Commission
MEM	Malaysia Economic Monitor
MGS	Malaysian Government Securities
MOF	Ministry of Finance Malaysia
MPC	Monetary Policy Committee
MRT	Mass Rapid Transit
MAFS	Ministry of Agriculture and Food Security
MyGIF	Malaysian Government Interoperability Framework
MyGDX	Malaysian Government Central Data Exchange
MySTEP	Malaysia Short-term Employment Program
NBDAC	National Big Data Analytics Center
NPL	Non-performing Loans
OE	Operating Expenditure
OFS	Ombudsman of Financial Services
OECD	Organization for Economic Co-operation and Development
OPR	Overnight Policy Rate
PDPA	Personal Data Protection Act
PIT	Petroleum Income Tax
PITA	Petroleum Income Tax
PICS-3	3rd Productivity and Investment Climate Survey
PPI	Producer Price Index
PPP	Purchasing Power Parity
PSP	Payment Service Provider
RMK-12	12th Malaysia Plan
REER	Real Effective Exchange Rate
R&D	Research and Development
RTS	Rapid Transit System
SAZ	Special Agriculture Zone
SMEs	Small and Medium Sized Enterprises
SST	Sales and Services Tax
TFP	Total Factor Productivity
Y/Y	Year-on-Year

Table of Contents

Executive Summary

Global and regional developments

Global

Global growth has slowed markedly, edging closer to falling into recession. Advanced-economy growth slowed from 5.3 percent in 2021 to an estimated 2.5 percent in 2022, the fourth fastest deceleration of the past 50 years. Economic conditions deteriorated substantially in H2 2022 as persistent high inflation eroded the purchasing power of households and dented confidence. Moreover, rapid, and synchronous monetary policy tightening around the world has contributed to a significant worsening of global financial conditions, exerting a substantial drag on economic activity.

Regional

Meanwhile, growth in the East Asia and Pacific (EAP) region, excluding China rebounded, diverging from the global trend, as mobility restrictions were removed. Excluding China, the pace of growth doubled, rising to 5.6 percent in 2022. Growth was supported by a release of pent-up demand as many countries continued to lift pandemic-related mobility and travel restrictions. Meanwhile, consumer price inflation increased across the region in 2022 mainly reflecting increases in energy and food prices. In some countries like Indonesia, Philippines, and Thailand it has exceeded targets for several months.

Domestic developments

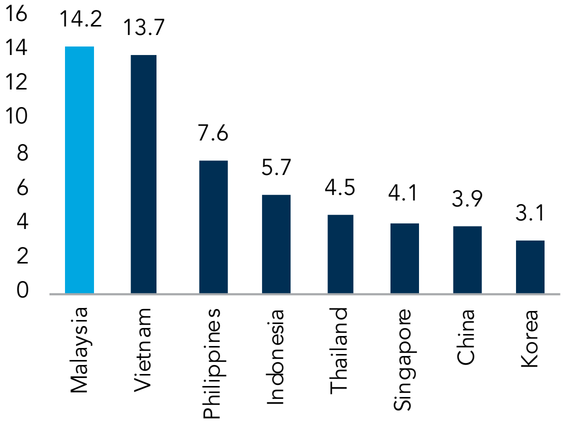
Malaysia posted strong growth in Q3 2022

Malaysia's growth during the quarter was also the highest relative to other regional countries. Like its regional peers, the Malaysian economy bucked the global trend and recorded a strong growth in Q3 2022 (Figure i). The economy expanded at 14.2 percent (YoY) (Q2 2022: 8.9 percent). Malaysia's strong performance in Q3 2022 – and for 2022 overall –was in part due likely to the withdrawals from the Employees Provident Fund (EPF) which contributed to higher private consumption in Malaysia than in other countries. In addition, improved labor market conditions, other government policy measures such as the increase in the minimum wage and cash assistance programs such as *Bantuan Keluarga Malaysia* provided additional support. On the supply side, all economic sectors expanded during the period.

FIGURE i

Malaysia's growth during in Q3 2022 was the highest among other regional countries.

GDP growth, y/y percentage



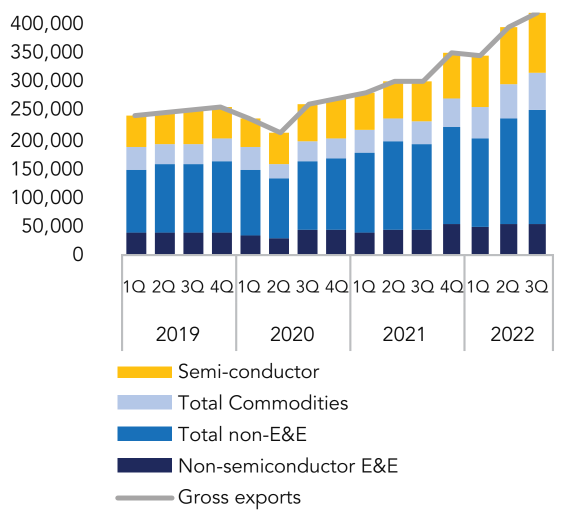
Source: Haver, DOSM

On the external front, strong demand for both E&E and non-E&E products contributed to a rise in gross exports in Q3 2022 (Figure ii). Gross exports expanded faster by 38.3 percent in Q3 2022 (Q2 2022: 29.9 percent), underpinned by a broad-based increase in external demand across all manufacturing products and by higher commodity prices. On balance, the current account recorded a higher surplus of 3.1 percent of GDP during the quarter (Q2 2022: 1.0 percent).

FIGURE ii

Gross exports continue to expand due to strong demand for both E&E and non-E&E products.

Gross export growth, RM million



Source: World Bank staff calculations based on BNM and DOSM data

Despite strong export growth, the real effective exchange rate (REER) continues to decline. Malaysia's REER has been on a downward trend since Q2 2018, depreciating by almost 8 percent between Q2 2018 and Q3 2022. Meanwhile, the REER in other countries in the region has broadly risen. The REER is a more appropriate measure of external competitiveness, compared to bilateral exchange rates since the REER is the weighted average of the bilateral real exchange rates between the country and all its trading partners (the weights are the respective trade shares of each partner).

Analysis on the effects of ringgit depreciation shows that it could increase the cost of living but also be favorable for economic growth. New empirical findings suggest that, between the 1990 – 2022 period, ringgit depreciation of 1 percent against the US dollar is associated with a 1 increase in real GDP; a 0.4 percent increase in prices. and a 0.8 percent increase in real net exports (see Box 2: Currency Depreciation in Malaysia could have a Positive Spillover Effects on Real GDP). On the one hand, these results suggest that a depreciation of the ringgit could lead to an increase in the cost of living as the price of imported goods and services in the consumer's basket rises. On the other hand, the depreciation could be favorable for economic growth through an increase in the country's international competitiveness and net exports.

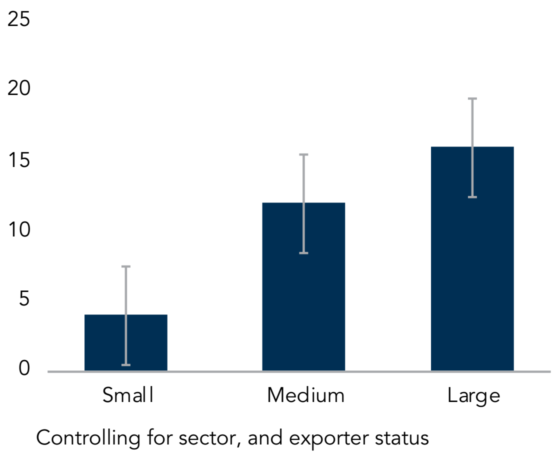
Recovery is broad-based across firms and sectors

The results from the Business Pulse Survey (BPS) in August 2022 show recovery becoming more entrenched following the reopening of international borders (Figure iii). Recovery is broad-based with firms of all sizes and across all sectors achieving positive changes in sales relative to the same period pre-pandemic. Nonetheless, large firms still lead the way in sales growth. On government support programs for COVID-19 assistance, the share of firms that perceive the end of government support to be harmful has increased from 13 percent in February 2022 to 20 percent in August 2022 against the backdrop of input price volatility. Correspondingly, the proportion of respondents that perceived such government support is not needed for recovery has dropped from 33 percent to 27 percent. On the most needed assistance from government in the next six months, firms rank that the most prioritized government support needed is to expedite and expand digitalization programs to increase efficiency. 17 percent of firms rated digitalization programs as their most sought-after support from the government.

FIGURE iii

Sales have reverted to positive figures following international re-opening.

Average change in sales during past 30 days compared to 1Q 2022, percentage



Source: World Bank Business Pulse Survey (BPS) August 2022

In addition, findings from the BPS show that firms face new headwinds amidst international re-opening and recent global developments. The overall rise in costs affects a substantial proportion of firms where 43 percent of firms experienced increased input costs compared to the pre-pandemic level, with an average increase in costs of 12 percent. Close to half of the firms surveyed reported being affected by price controls. Extensive use of price controls over a long period distorts the market and ironically, may exacerbate the shortages of the product in question. Out of the firms reportedly affected by price controls, 37 percent of firms say they reduced production by an average of 24 percent.

Economic recovery was supported by improvement in labor market conditions

The momentum in labor market recovery continued in Q3 2022. The unemployment rate declined to 3.7 percent in Q3 2022 (Q2 2022: 3.9 percent), albeit higher than the pre-pandemic level of 3.2 percent in Q4 2019. There was also a slight increase in labor force participation, from 69.2 percent in Q2 2022 to 69.4 percent in Q3 2022.

Both time-related and skills-related underemployment rates are declining. The decline is more rapid for time-related underemployment which fell to 1.2 percent in Q3 2022 (Q2 2022: 1.4 percent), suggesting that it is more likely driven by the pandemic-related economic crisis. Meanwhile, the decline in skills-related underemployment is smaller (Q3 2022: 36.8 percent), suggesting that structural factors such as skills mismatch appear to play a stronger role. Data as of Q3 2022 showed that there are large gender differences in both time- and skills-related underemployment during the pandemic: underemployment was lower among women. One potential reason for this may be due to rising care responsibilities, which decreased willingness and ability to work more hours. Data for 2019-2021 shows an increase in the number of women outside of the labor force who are engaged in housework/family responsibilities.

There was a general increase in labor productivity and employment in correspondence to the reopening of the economy. Overall labor productivity rose to 10.1 percent in Q3 2022 (Q2 2022: 5.5 percent). The construction sector saw the greatest improvement in labor productivity at 14.9 percent (Q2 2022: 2.9 percent) followed by the services sector, which expanded by 11.4 percent (Q2 2022: 7.5 percent). Employment wise, services saw the largest increase of 4.8 percent (Q2 2022: 4.2 percent), followed by manufacturing, which grew by 4.6 percent (Q2 2022: 5.0 percent).

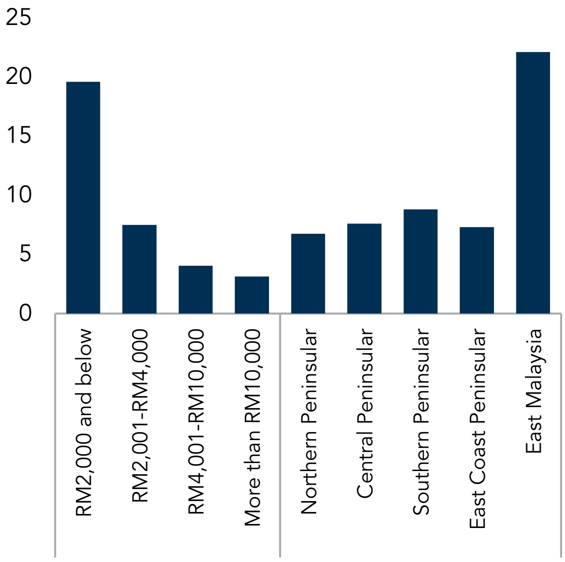
However, certain segments remain vulnerable despite the recovery

Nevertheless, the impact of the economic rebound remained uneven, with poor and vulnerable groups experiencing slower recovery. The 3rd round of the World Bank's High-Frequency (HiFy) Phone Survey showed that as of May 2022, work stoppages among pre-pandemic lower-income workers stood at 25 percent compared with 15 percent among their higher-income peers. Moreover, nearly 70 percent of lower-income households self-assessed themselves as having inadequate financial resources to meet their monthly basic needs, and more than 60 percent of these households reported having no savings.

Recent increases in food and energy prices have further exacerbated the lingering effects of the pandemic on poor households. This slower progress in recovery of poor households from the pandemic has been exacerbated by the recent surging in food prices, with the trend of food security among the poor being reversed and worsened from May 2022. Despite various price controls and subsidies provided, one in five of poorest households (earning RM 2,000 and below) reported running out of food in the 30 days prior to the HiFy (Figure iv) survey. To some extent, this disproportionate impact is expected, mainly because poor households spend a higher percentage of their income on food.

FIGURE iv
Food insecurity remained higher among lower-income and East Malaysian households.

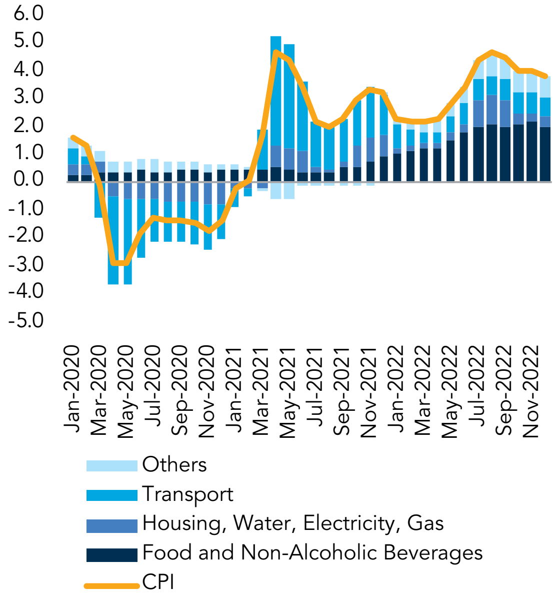
Households running out of food, percentage



Source: World Bank High-Frequency Phone Survey Round 3 (2023)

FIGURE v
Higher food, housing and utility prices have contributed to an upward trend in inflation.

Contribution to consumer price inflation, percentage



Source: DOSM and World Bank Staff Calculations

Worryingly the incidence of severe food insecurity has been increasing in Malaysia. In 2019 - 2021, the prevalence of moderate or severe food insecurity in Malaysia was 15.4 percent which is equivalent to 5 million people. Insufficient diversification in domestic production has led to growing imports in important categories of food products, especially meats and edible offal, maize, and soybeans. This has adversely impacted the poor in Malaysia (see Box 4 on Food Security Challenges in Malaysia).

Rising food and utility prices have contributed to the uptrend in inflation

After rising steadily in the 2Q and 3Q of 2022 on higher food and utility prices, consumer price inflation in Malaysia has started to moderate. Consumer price inflation in Malaysia moderated to 3.8 percent in December 2022 (November: 4.0 percent) while core inflation was estimated at 4.1 (November 2022: 4.2 percent). The moderation in consumer price inflation in food and beverage prices contributed to the lower increase in national inflation (Figure v). Relative to regional peer countries and around the world, inflation has remained broadly stable in Malaysia, mostly due to blanket fuel subsidies and price controls. Estimates suggest that complete removal of fuel price subsidies is likely to cause a 9.0 percent increase in consumer prices, and the impact across sectors is expected to be uneven (see Box 5 on Analysis on Sudden Fuel Subsidies Removal).

While consumer price inflation has risen, producer price inflation has fallen. This is mainly driven by broad-based decline in production index across sectors on easing of labor shortage and improvement in crop yields in the plantation sectors. Producer price inflation was estimated at 3.2 percent in November 2022, (October: 4.0 percent). This decline in producer price inflation has been underpinned by a consecutive decline in the producer price index in agriculture, forestry, and fishing, and a lower growth in the price index cross all remaining sectors.

The central bank pre-emptively raised the interest rate to 2.75 percent to manage price pressures

The recent increase by the central bank on its overnight policy rate (OPR) was a pre-emptive move to manage the risk of excessive demand on price pressures, balancing the risks to domestic inflation and sustainable growth. The adjustment in November 2022 was for the fourth consecutive rate hike, and the OPR now stands at 2.75 percent, below its pre-pandemic level of 3.00 percent. Despite the recent uptake in inflation, the committee still expects annual inflation rate in 2022 to be between 2.2 and 3.2 percent.

The banking sector remains well-capitalized and has ample liquidity. Capital ratios remained well over the regulatory minimum capital level, and the liquidity coverage ratio and net stable funding ratio remained high above the statutory requirement of 100 percent, supported by sustained growth in deposits. In addition, whilst total volume of impaired or non-performing loans (NPLs) are on the rise, the gross NPL ratio remains relatively low at 1.82 percent in Q3 2022 (Q2 2022: 1.65 percent) compared to levels experienced in the previous crises. In addition, banks have set aside provisions for NPLs and have substantial capacity to absorb the expected increases in NPLs.

Since the expiry of standardized repayment assistance, the share of business loans under repayment assistance has declined. As of end-June 2022, the share stood at just 14.8 percent of total banking system loans (including development financial institutions) (Dec 2021: 26.6 percent). Moving forward, financial institutions have been given the flexibility to address repayment issues on a case-by-case basis. Struggling borrowers can approach the Credit Counselling and Debt Management Agency (*Agensi Kaunseling dan Pengurusan Kredit,* AKPK) to seek advice on financial education, advisory and debt management services.

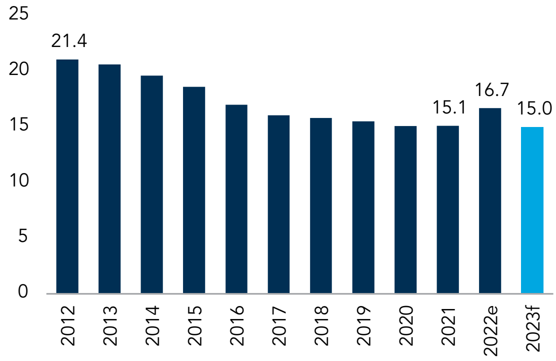
In the domestic financial markets, monetary policy tightening by the Fed in the US has led to portfolio outflows and rising volatility. In the domestic bond market, portfolio outflows have led to higher local government bond yields across all maturities. The increase in the yield is also partly due to the increase in the OPR by BNM. Nevertheless, deep liquidity from local institutional investors helped to cushion the increase in bond yields. Similarly, in the equity market, portfolio outflows have led to heightened volatility in the domestic equity market.

Fiscal space is expected to remain narrow in the near term

After a temporary increase in 2022, government revenue is expected to resume its declining trend in 2023 (Figure vi). In 2022, government revenue is projected to increase to 16.7 percent of GDP from 15.1 percent in 2021, driven mainly by higher petroleum-related revenue. With crude oil prices expected to moderate in 2023, revenue is expected to decline to 15.0 percent of GDP. In addition, Malaysia continues to under collect in personal and consumption taxes, trailing many comparative peers.

FIGURE vi
Government revenue is expected to decline in 2023 after a slight increase in 2022.

Federal government revenue, Percentage of GDP

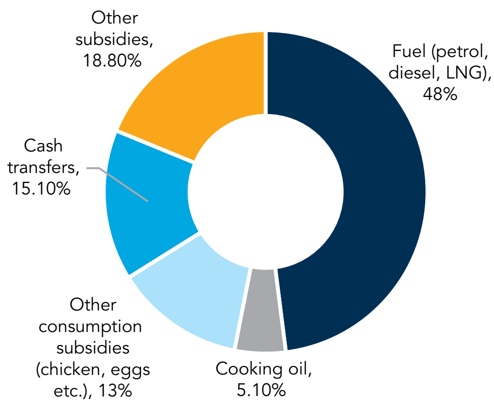


Source: MOF

Following higher global oil prices, total government expenditure increased in 2022 due to higher subsidies spending. The outlays for subsidies and social assistance are estimated to increase markedly to 3.4 percent of GDP in 2022 (2021: 1.5 percent) as the government capped the retail prices for RON95 (fuel) and diesel during the year. Blanket, untargeted fuel subsidies took up the larger share of subsidies spending in 2022 (Figure vii). It is estimated by the government that the total expenditure on blanket fuel subsidies amounted to about 2.4 percent of GDP. In comparison, the spending allocation for Ministry of Health, and Ministry of Education in 2022 stood at 1.9 percent and 3.1 percent respectively. For 2023, the government expects subsidies spending to moderate slightly to 2.3 percent of GDP as global oil prices are expected to subside.

FIGURE vii
Fuel subsidies took up the largest share of the subsidy bill in 2022.

Breakdown of subsidy spending in 2022, percentage of total subsidies



Source: MOF

Rigid expenditures remain high and are expected to increase in 2023. Rigid expenditures – namely obligations related to salaries, pensions, and interest payments stood at around 56 percent of total government spending in 2022 (2021: 66 percent). Moving forward, the combined spending on these structural expenditures is expected to increase to 61 percent of total government expenditures in 2023. The increased spending on these items, together with the decline in revenue, remains a constraint to the government's fiscal space and posing a challenge to long-term fiscal sustainability.

Government debt remains close to its statutory limit of 65 percent of GDP. As at end-June 2022, the Federal Government debt stood at 61 percent of GDP (end-2021: 63.4 percent). There was a noticeable increase in federal government debt during the pandemic and the government expects the statutory debt-to-GDP ratio to increase to 63 percent by end-2023. The government also stated that it may extend the 65 percent debt limit beyond the current expiry of end-2022.

The government is expected to table a revised budget under the current new administration. The government tabled a partial budget in December 2022 to approve emoluments for civil servants. Following that, the government is expected to re-table the budget February 2023.

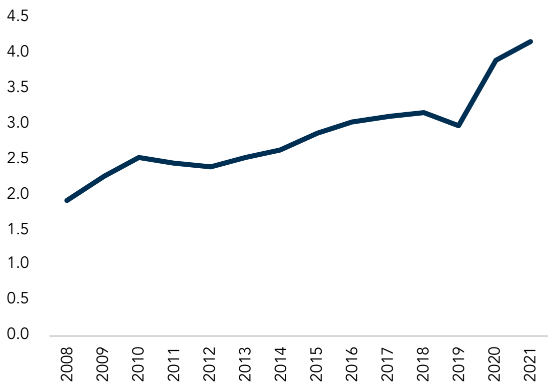
New analysis on Malaysia's revenue, spending and debt trends suggest that fiscal policy in Malaysia has been countercyclical relative to regional countries. Using annual data from 1990 to 2022 for Malaysia the empirical findings suggest that: i) spending policy in Malaysia is slightly countercyclical or acyclical; ii) tax policy is acyclical; and iii) debt policy is highly countercyclical. This signals that there is an increase in government spending during periods of slowdown to support the economy and should be viewed positively. Overall, these results are consistent with the cyclical behavior of fiscal policy in most advanced economies (see Box 6: Cyclicality of Malaysia's Fiscal Policy). Apart from Thailand and Indonesia, fiscal policy in Malaysia is also found to be more countercyclical than any other developing East Asian country. However, tax policy is not as countercyclical/ acyclical relative to the rest of the region. This fact could be driven by the petroleum income tax in Malaysia, which is a main component of tax revenues in the country.

With government revenue projected to remain low and structural expenditures to remain high, this has led to further narrowing of Malaysia's fiscal space (Figure viii). The government has reiterated its commitment towards consolidating the fiscal position for a more sustainable public finance in the medium term, guided by the medium-term fiscal framework (MTFF). The current framework pursues an expenditure-driven fiscal consolidation with operating expenditures expected to decline from 15 percent of GDP in 2023 to around 14.5 percent over the MTFF period (2023-2025). The government also expects revenue to decline over this period, from 15.0 percent of GDP in 2023 to an average of 14.7 percent in 2023-2025.

FIGURE viii

Fiscal space is expected to remain narrow

Federal government debt to federal government revenue, ratio



Source: World Bank staff calculations based on Aizenman and Jinjarak (2010)
Note: Higher ratio indicates narrower fiscal space

However, the current fiscal consolidation strategy via spending reduction is challenging, given the current spending rigidity. On the spending side, there could be savings from moving from blanketed subsidies, particularly in fuel, to more targeted ones (see previous discussion). However, relying on spending reduction is challenging. In part, this is due to combined spending on structural expenditure being already at high levels; and secondly, other OE components such as supplies, and services have been on a declining trend or are already at low levels. As such, the government's current fiscal consolidation plan needs to prioritize a higher revenue collection target. With Malaysia's revenue level remaining low and trailing comparative peers, it is important to address the persistent decline in revenue collection and explore new sources of revenue mobilization.

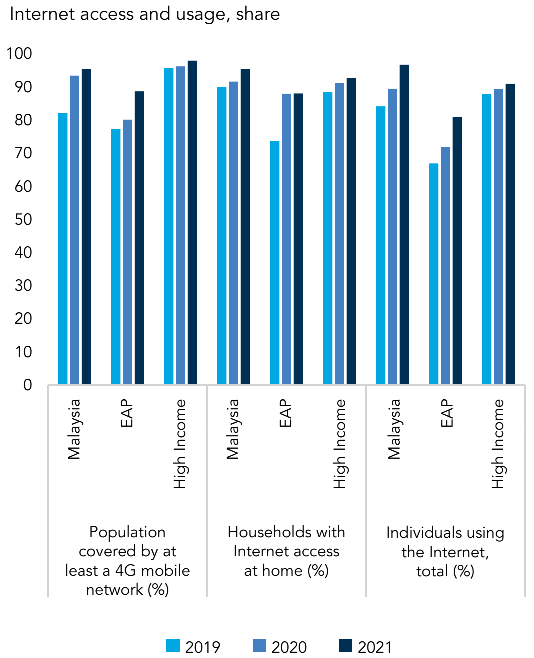
Special Topic: Expanding Malaysia's Digital Frontier

The COVID-19 pandemic accelerated digitalization in Malaysia, with digital platforms and services helping to reduce the economic, social, and health costs of the pandemic. While this trend was already underway in Malaysia, the greater availability of digital products and services, across a wide range of sectors during the pandemic played an important role in maintaining economic activity amidst lockdowns, social distancing, and other mobility restrictions and helped to increase the efficiency of public response during the pandemic and recovery period. Globally, there is growing evidence that digital technologies can contribute to growth, productivity, employment, and poverty reduction.[1]

In Malaysia, there has been widespread increase in connectivity among households (Figure ix). For instance, the pandemic triggered a rapid expansion in access and usage of internet with almost 97 percent of the population using the internet in 2021, up from 84 percent in 2019.

FIGURE ix

The pandemic triggered an expansion in access and usage of internet.

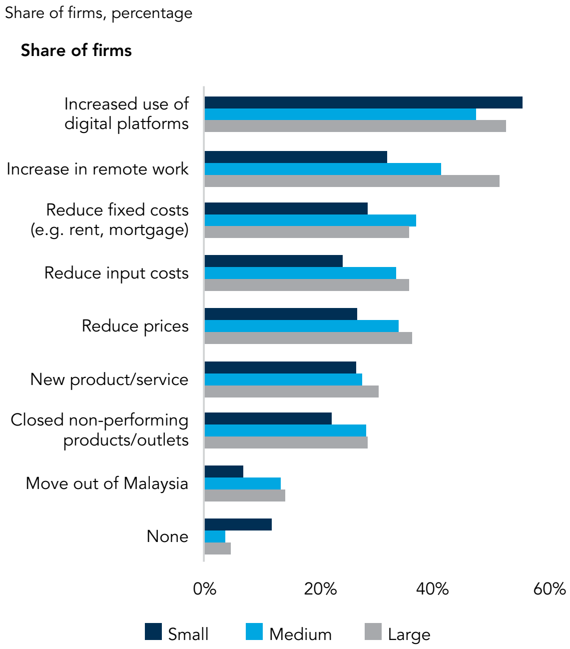


Source: ITU 2022

The pandemic also accelerated digitalization among firms, with their most common coping strategy being to increase adoption of digital platforms. Moreover, enterprises that made digital investments throughout the pandemic coped better with the pandemic shock (World Bank 2020c) (Figure x).

FIGURE x

The pandemic also accelerated the digitalization of firms, particularly in the use of digital platforms.



Source: BPS in World Bank (2022c)

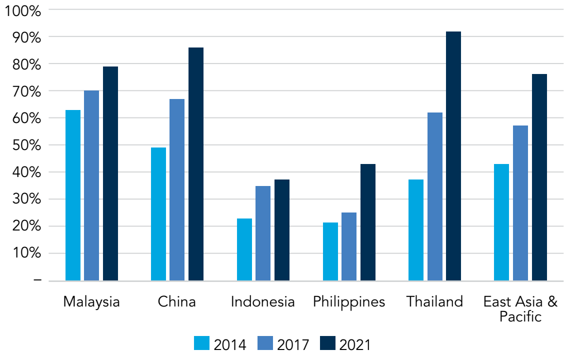
The adoption of digital platforms in Malaysia was reflected in a sharp increase in digital payments, an important entry point to the use of formal financial services and to the digital economy more generally. World Bank Global Findex data (2021) showed that about 5 million Malaysians making their first digital merchant payment after the COVID-19 pandemic began. Trade in digital services also grew, with the share of digitally deliverable services of total services exports at almost 50 percent in 2020 in Malaysia, up from 22 percent in 2010.

1 A growing volume of over 100 academic research papers provides increasingly robust evidence that digital connectivity contributes to a wide range of positive economic outcomes, including growth, employment, and poverty reduction as summarized in the World Bank *Development Committee Ministerial Plenary Paper, Spring Meetings 2022.*

FIGURE xi

The pandemic also accelerated the uptake of digital payments, a key entry point into the digital economy.

Percent of adults who made or received digital payments in the last year



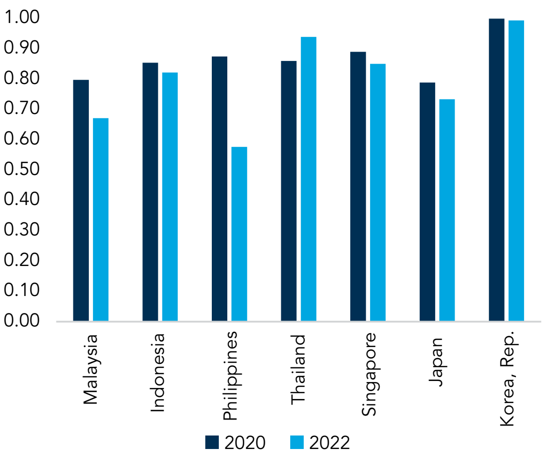
Source: Staff analysis of World Bank Findex Database (2021)

Malaysia has also advanced digitalization of government services. Many ministries are reporting between 70 and 90 percent of their services are end-to-end (E2E) online or fully digitalized in 2022. For several aspects of e-government, Malaysia compares relatively well with regional across several aspects of e-government", (i.e. Malaysia compares relatively well with regional peers across several aspects of e-government). For example, in the Public Service Delivery Index,[2] Malaysia ranks 51 of 198 economies, outperforming Indonesia and the Philippines and on par with Thailand. However, Malaysia trails regional peers and high-income countries in the adoption of citizen-centric digital solutions which would enable a more user-centered delivery, as indicated by the digital citizen engagement index (Figure xi).

FIGURE xii

Malaysia trails peers and high-income countries in citizen-centric digital solutions.

Digital citizen engagement index



Source: World Bank GovTech Dataset (2022)

Despite substantial progress, Malaysia still faces challenges in its efforts towards greater digitalization, with a marked digital divide exacerbated during the pandemic. For example, there are marked differences in internet use across regions, and a rural-urban gap of about 10 percentage points in household Internet use (ITU, 2022)[3]. High access costs and slow connection speeds also hinder digitalization. Fewer SMEs than large and medium firms in Malaysia turned to advanced digital solution during COVID-19, with more than 80 percent of medium and large firms invested in digital solutions compared to 54 percent of small firms (World Bank, 2022c).

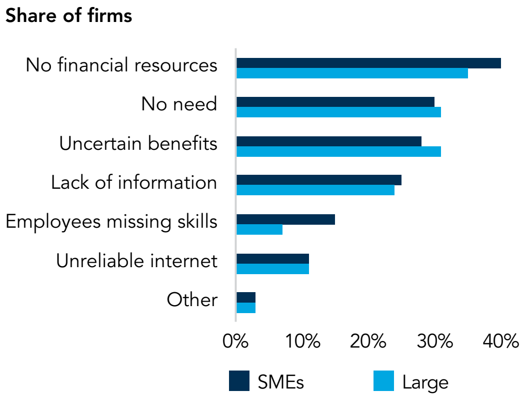
There are gaps in the use of digital financial services among smaller firms, the bottom 40 percent of the households (B40), unemployed, recipients of social transfers, women, youth, and individuals in rural areas. For example, the B40 is more likely to be unbanked than richer adults, and less likely to make digital payments. There are also geographic disparities, with 2022 Ministry of Finance data showing use of cash for the government program *Bantuan Keluarga Malaysia* (BKM) ranging from 2.4 to 6.9 percent of recipients depending on state.

Constraints to the adoption of digital technologies remain. Key constraints include the relatively higher cost and slower internet connectivity, as well as the lack of financial resources and digital skills. Limited financial resources were the top constraint cited by SMEs preventing them from adopting digital technologies, both before and during the pandemic (Figure xiii). For the B40, lack of financial resources, along with limited financial literacy, and lack of digital skills were reasons commonly cited as constraints to utilize digital technologies.

FIGURE xiii

The top constraint for firms to digitalize was lack of financial resources.

Reasons for firms to not invest in digital during COVID-19, percentage



Source: BPS in World Bank (2022c)

2 The World Bank GovTech Maturity Index (GTMI) is a broader measure of the extent of digital transformation in the public sector capturing digitalization of core government systems, citizen engagement, and a wide range of GovTech enablers.

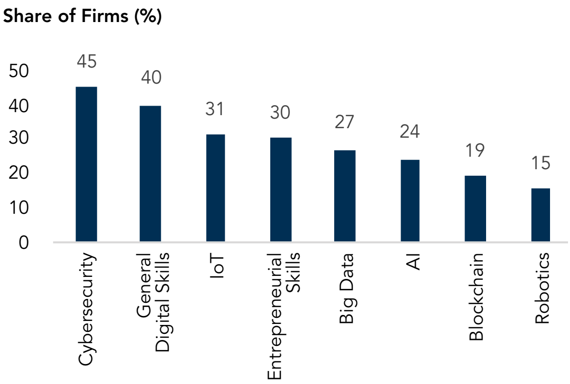
3 See: https://www.itu.int/en/ITU-D/Statistics/Dashboards/Pages/Digital-Development.aspx

Skills are the constraint most cited by firms to further develop digital opportunities. The BPS survey (February-March 2022) shows that know-how around cybersecurity is a particular area of need and often being outsourced, followed by general digital skills (Figure xiv).

FIGURE xiv

Lack of digital skills are cited by firms as a constraint to developing digital opportunities.

Firms outsourcing types of skills due to lack of technical expertise, percentage



Source: World Bank, BPS 2022

Evidence from the Malaysia's Critical Occupations List (COL) suggests that the demand for advanced digital skills have been increasing more rapidly than its supply. Moreover, five out of the six occupations requiring advanced digital skills that appeared in the 2018/2019 COL remained on the list for the past six years, indicating a consistent lack of those skills. Moreover, government programs were more focused on supporting firms in digitalizing front-end functions and back-end function, rather than filling skills gap among prospective employees in Malaysia (World Bank 2022c). Public sector employees also face skills gaps that can impede the goal of digital transformation of government, particularly in the analysis of data.

Economic outlook

Sharp slowdown in global growth expected in 2023

Global growth is forecast to decelerate sharply to 1.7 percent in 2023 (2022e: 2.9 percent). This reflects synchronous policy tightening, worsening financial conditions, and continued disruptions from Russia's invasion of Ukraine. For advanced economies, growth is projected to slow markedly to 0.5 percent (2022e: 2.5 percent) as central banks continue to tighten monetary policy to contain inflationary pressures, labor markets cool, and pressures in energy markets in Europe persist.

In the EAP region, growth is projected to firm to 4.3 percent in 2023 (2022e: 3.2 percent) as the easing of pandemic-related restrictions allows activity in China to pick up. Excluding China, growth is projected to moderate to 4.7 percent in 2023 and 2024 (2022f: 5.6 percent) as pent-up demand dissipates and weaker growth of goods exports offset belated recovery in tourism and travel.

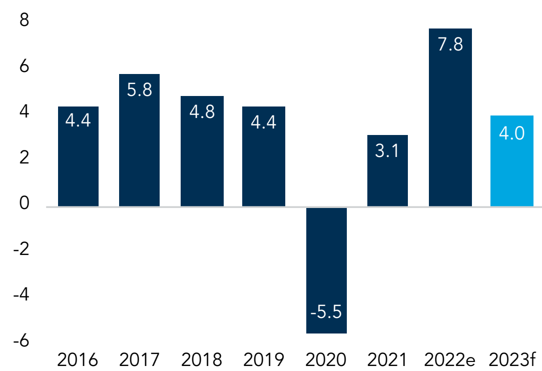
Malaysia's economic growth is projected to moderate in 2023

Malaysia's economy is projected to grow at a more moderate pace of 4.0 percent in 2023 (Figure xv). Domestic private sector spending is expected to remain as the main driver of growth this year amid an expected slowdown in external demand. Private consumption is forecast to expand at a slower but still relatively robust rate of 6.7 percent in 2023 (2022e: 11.2 percent), sustained by the improvements in labor market conditions, as well as ongoing household income support from the government.

FIGURE xv

Malaysia's economy is projected to expand at a more moderate rate of 4.0 percent in 2023.

GDP, y/y, percentage



Source: World Bank Global Economic Prospects

Gross fixed capital formation (GFCF) is projected to increase by 4.2 percent in 2023 (2022e: 5.3 percent), reflecting the continued flows of capital investments in the private and public sectors. Capital expenditure in the private sector is expected to continue to be driven by ongoing and new multi-year investments in the technology-intensive manufacturing and services sectors. Capital spending by the government is expected to be mainly directed towards upgrading of public infrastructure and amenities including ECRL, LRT3, MRT3, RTS Link, Sarawak-Sabah Link Road Phase 2, and Trans Borneo Highway.

As the global environment becomes less supportive, trade growth is expected to moderate in 2023. Malaysia's export growth is projected to slow to 2.2 percent in 2023, in line with softening global growth prospects and weakening international trade momentum. Similarly, import growth is projected to moderate to 2.1 percent in 2023 (2022e: 15.3 percent) reflecting the slower import growth across consumption, intermediate, and capital goods.

Headline consumer price inflation is projected to moderate to between 2.5 and 3.0 percent in 2023 (2022e: 3.3 percent). This is mainly driven by the easing of global supply constraints and stabilizing of commodity prices. This forecast assumes that the ceiling on retail fuel prices and price control measures on selected food items remain in place throughout the year, limiting cost pressures from the prevailing global oil and food prices. Meanwhile, underlying inflation, as measured by core inflation (i.e., excluding food and fuel prices), is expected to remain around 3 percent.

As a highly open economy, Malaysia will continue to face substantial risks emanating from the external environment. Shocks to global growth – including higher-than-expected inflation, tighter financial conditions, deeper slowdown in major economies, a prolonged war in Ukraine, could cause a sharper-than-expected slowdown in global growth. It is estimated that a 1 percentage point decline in GDP growth of the G7 economies and China, could lower Malaysia's growth by 1 and 0.7 percentage point, respectively.

On the domestic front, the main sources of downside risk relate to the uncertainty surrounding inflation and relatively high debt levels. Broader and more persistent price pressures in Malaysia may necessitate further monetary policy adjustments to dampen domestic demand over the near term. In addition, a decline in real disposable household incomes from higher prices could also weigh on the strength of consumer spending. The relatively high levels of non-financial corporate debt (H1 2022p: 104.4 percent of GDP) and household debt (H1 2022p: 84.5 percent of GDP) amid tightening financial conditions may weigh more heavily on private investment and consumption.

Policy recommendations

Near-term focus should be on supporting the vulnerable and rebuilding fiscal buffers

A move toward targeted subsidies is required. Putting in plans to phase out blanket, broad-based subsidies and moving towards a more targeted subsidy framework that would benefit lower income households is relevant and timely. In the case of fuel subsidies for example, targeted cash transfers to lower-income households could be introduced in lieu of fuel subsidies. The shift towards a targeted framework should also be gradual, as a sudden and abrupt complete removal could lead to a sharp increase in inflation (see Box 5 on Analysis on Sudden Fuel Subsidies Removal). In addition, the mechanics should be implementable in a way that minimizes transaction costs.

There is an ongoing need to better understand and properly measure poverty and inequality. This is so that responses and policies can be rolled out more effectively and equitably. The government is currently considering an update of its poverty line income and multidimensional poverty index. This is not only timely but also important to improve poverty measurement to a standard commensurate with Malaysia's current living standards and state of development. In the same spirit, the government may wish to revisit the current narrow focus on 'hardcore poor', as it misses out many vulnerable groups, such as informal and younger workers.

The government's current fiscal consolidation plan should include raising its revenue collection. Currently, the government's fiscal consolidation projects government revenue to decline further from 15.0 percent of GDP in 2023 to an average of 14.7 percent in the medium-term. With Malaysia's revenue level remaining low and trailing comparative peers, it is important to address the persistent decline in revenue collection and explore new sources of revenue. As such, efforts to rebuild fiscal space and increase it would have to be driven by both higher revenue collection and better spending efficiency. The Fiscal Responsibility Act (FRA) which is being drafted and finalized, should include detailed plans on measures to diversify its revenue sources. Consideration should be given to streamlining reliefs and broadening the tax base of personal income tax and by enhancing the consumption tax framework.

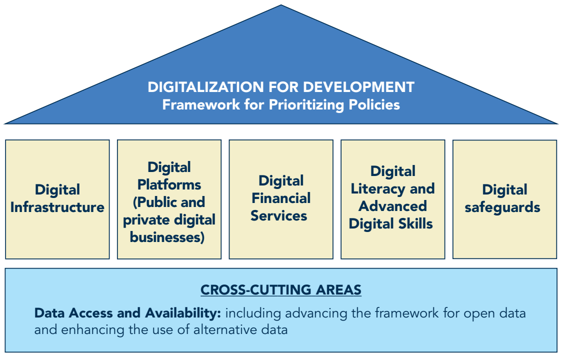
Maximizing the developmental dividends of digitalization

Malaysia can harness and leverage the opportunities brought on by the greater digitalization trend post-pandemic while managing risks. Building on the framework presented in the Development Committee Ministerial Plenary Paper (2022), developing an inclusive, dynamic, and safe digital economy involves building solid foundations in five critical policy areas (Figure xvi): (i) digital infrastructure, (ii) digital platforms, (iii) digital financial services; (iv) digital literacy and advanced digital skills and (v) digital safeguards, such as data protection and cybersecurity, along with a focus on data access and availability that cuts across these five priority policy areas. These policy priorities are not intended to cover every aspect of the digital economy, but rather those that are key enabling factors to maximize the development dividends of digitalization while managing key risks.[4]

4 Development Committee

FIGURE xvi

Digitalization for Development: Framework for Prioritizing Policies.



Source: Adaptation from World Bank Development Committee Ministerial Plenary Paper, Spring Meetings 2022

The first priority policy area addresses digital infrastructure, including issues of access and usage. Digital infrastructure enables people, the private and public sectors to go online, and untap the value of digital services. For the digital economy to flourish, access to meaningful connectivity (particularly affordable, high-speed internet), internet of things (ex: mobile devices, computers), and data repositories. For the digital economy to flourish, access to meaningful connectivity plays a key role. This can be supported by strengthening the enabling framework for competition, such as amending the Competition Act 2010 to include a mandate to control anti-competitive effects of mergers and acquisitions and easing foreign entry restrictions for telecommunications and network services, both of which could spur more private investment.

The second set of foundational policy priorities focuses on the promotion of a conducive environment for private and public digital platforms. Digital platforms offer products and services through channels, and digital public platforms can serve people and government agencies. Fostering the usage of open standards and open interfaces and ensuring interoperability of standards and systems to allow a seamless exchange of information and communication, for both public and private sector. Open data can increase transparency, improve public service, stimulate economic opportunities, encourage innovation, lead to new business models and services which can encourage innovation. At the same time, government adoption of digital technologies can be complemented with the promotion of social accountability tools, such as channels for citizen's direct monitoring with the goal of supporting user-centered delivery. Finally, Malaysia's logistics and customs can be improved, especially for e-commerce, with a fully integrated e-customs system (World Bank 2022c).

The third policy area involves fostering digital payments as an entry point for digital financial services. Greater efforts can be placed on digitalizing common cash payments in Malaysia to foster inclusion into the digital economy and lower transaction costs. This would include transitioning adults who are still making or receiving common payments in cash—for example, utilities, school fees, remittances, government-to-people (G2P) transfers—to digital payments. At the same time, regulators could reconsider current restrictions that inhibit e-wallet usage, which entails multiple actions through a bank account and are not permitted through agents. Finally, enhancing the availability and usage of alternative data, for example, on telco payments, can improve risk analysis and the development of customized financial products and services that could increase inclusion.

The fourth policy area supports initiatives to fill gaps in digital literacy and build advanced digital skills. Digital literacy is critical for workers to both catalyze and benefit from the new job opportunities created by the digital economy. There is the need to improve the accessibility and relevance of public support to develop digital skills for the workforce, for example, SME programs for digitalization[5] and collaborations with universities to incorporate digital skills into their curricula. Furthermore, there is a need to foster investments in digital skills across the public sector to maximize the benefits of GovTech[6], and to support consumers in acquiring basic digital financial literacy.

The final policy area supports strong safeguards to protect and foster trust in Malaysia's digital economy It includes measures such as i) digital authentication, ii) privacy/data protection, iii) consumer protection, and iv) an enhanced legal framework for cybersecurity. Appropriate government regulations can promote trust in the digital economy, making citizens and businesses willing to transact digitally. Having stronger safeguards includes building strong systems for digital identification and authentication. It would also expand the legal and regulatory framework for data privacy protection, beyond the 2020 proposed amendments to the 2010 Personal Data Protection Act (PDPA).[7] Strengthening Malaysia's framework for consumer protection for digital financial services, through enactment of the 2022 Consumer Credit Act proposal and development of a single window for financial consumer complaints to address the challenge of the current fragmentation of categories of consumer complaints under different government agencies. Finally, enhancing cybersecurity by reducing fragmentation in its legal framework can help protect users and businesses and strengthen Malaysia's resilience to cyberthreats.

5 While Malaysia has numerous digital support programs for SMEs, namely 101 programs identified in SME Digitalization Support Survey conducted in 2021, stakeholder consultations reveal that the multitude of agencies and programs can confuse SMEs seeking assistance

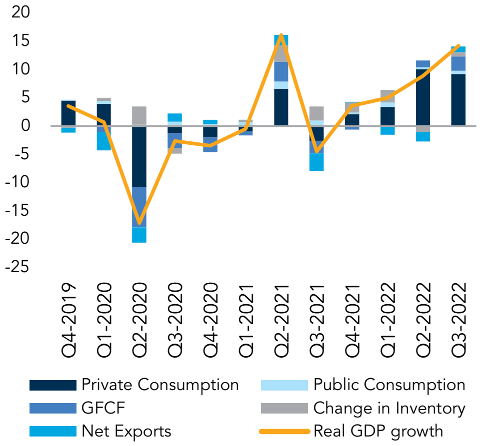
6 GovTech involves a whole-of-government approach to public sector modernization which promotes simple, efficient and transparent government with citizens at the center of reforms. It emphasizes three aspects of public sector modernization: i) Citizen-centric public services that are universally accessible, ii) A whole-of-government approach to digital government transformation, and iii) Simple, efficient and transparent government systems (World Bank 2021)

7 Personal Data Protection Department. 2020. KKMM. Review of Personal Data Protection Act 2010. https://www.pdp.gov.my/jpdpv2/assets/2020/02/Public-Consultation-Paper-on-Review-of-Act-709_V4.pdf

Recent trends in Malaysia's economy

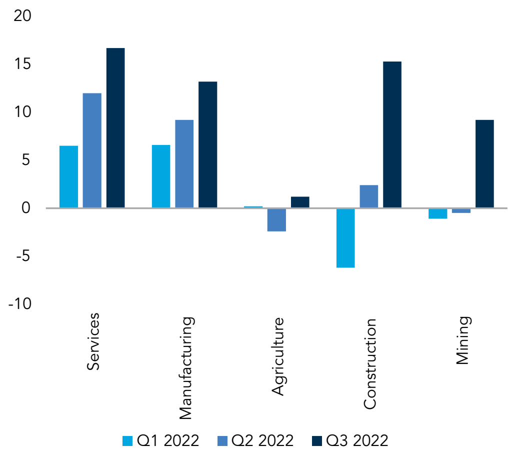
Malaysia's economy recorded a strong growth in Q3 2022...

Annual GDP growth, y/y percentage



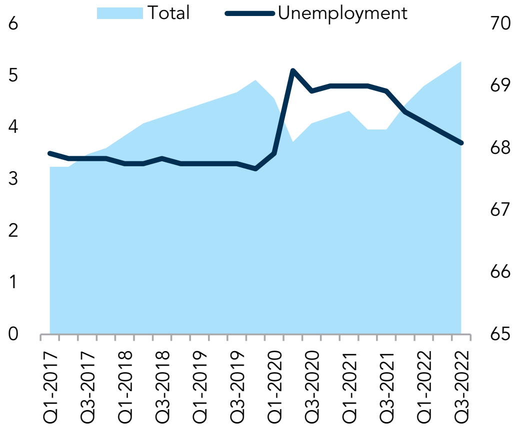
...with the manufacturing and services sectors leading the expansion.

Annual growth, y/y, percentage



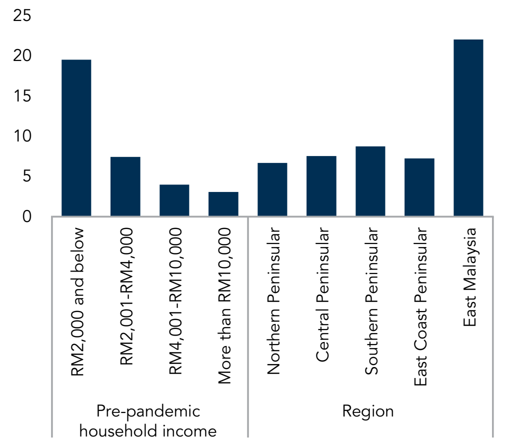
Recovery was supported by improvements labor market conditions...

Unemployment rate, labor force participation rate, percentage



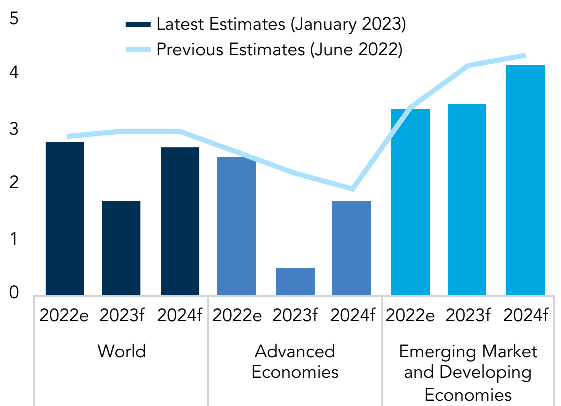
... although vulnerable households continue to face challenges, including food insecurity.

Households running out of food, percentage



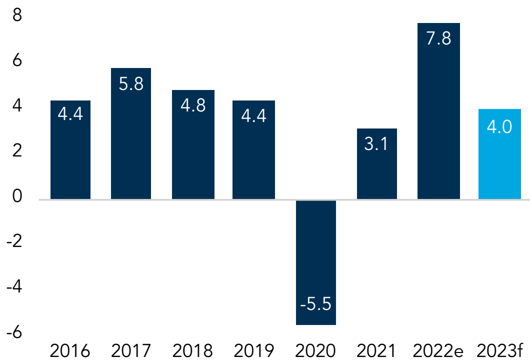
With global growth expected to decelerate sharply to 1.7 percent in 2023...

GDP, y/y, Percentage



... the economy is projected to expand at a more moderate rate of 4.0 percent in 2023.

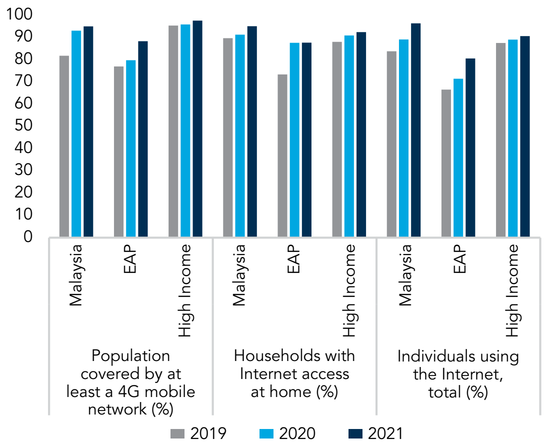
GDP, y/y, Percentage



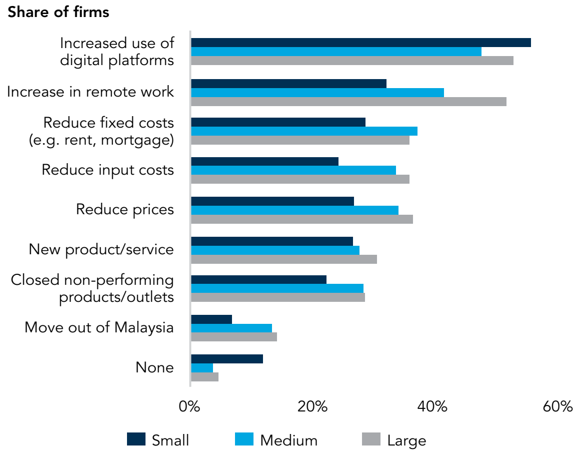
Expanding Malaysia's Digital Frontier

The pandemic triggered an expansion in access and usage of the internet…

Internet access and usage, share

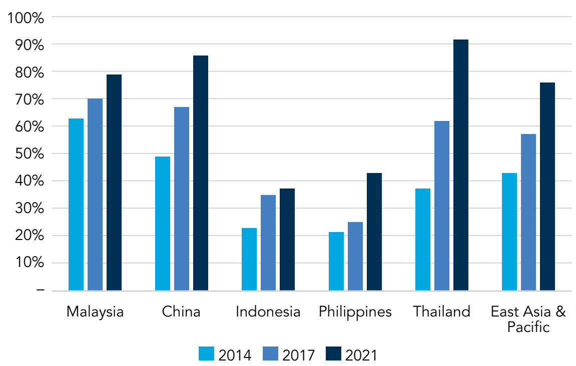


… and an acceleration of the digitalization of firms, particularly in use of digital platforms.



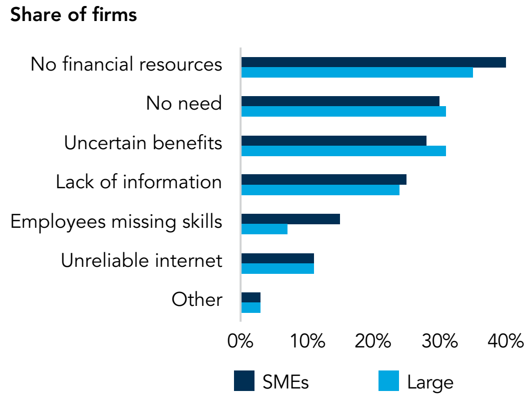
…and an acceleration of uptake of digital payments, a key entry into the digital economy

Percent of adults who made or received digital payments in the last year



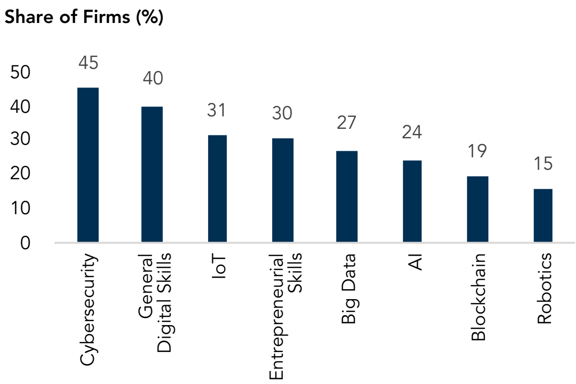
However, the top constraint for firms to digitalize was lack of financial resources.

Reasons for firms to not invest in digital during COVID-19, percentage



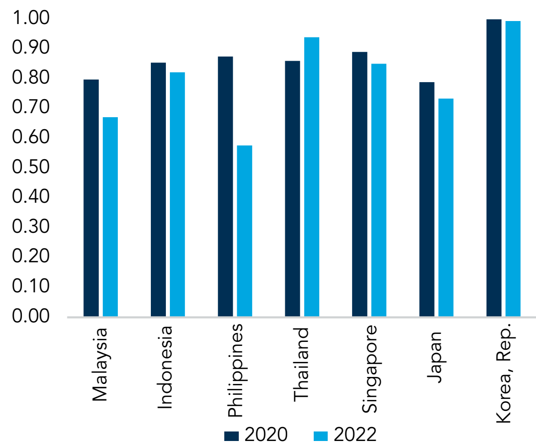
Lack of digital skills are cited by firms as a constraint to develop digital opportunities.

Firms outsourcing types of skills due to lack of technical expertise, percentage



Malaysia trails peers and high-income countries in citizen-centric digital solutions.

Digital citizen engagement index



Summary of policy recommendations: Expanding Malaysia's Digital Frontier

Outcomes	Key policy recommendations
1. Digital Infrastructure	**Catalyze private sector investments in infrastructure by strengthening the framework for competition:** i. Amend the Competition Act 2010 to include merger control powers (MT) ii. Ease foreign entry restrictions in telecommunications and network services (MT)
2. Digital platforms (public and private digital businesses)	**Catalyze platforms that support business growth and public efficiency:** i. Foster the usage of open standards, open interfaces, and interoperability of digital systems, including for cross-border transactions and government portals, and advance the framework for open data (MT). ii. Complement government adoption of digital technology with social accountability tools and user-centered digital services (MT) iii. Improve Malaysia's logistics management and customs, especially for e-commerce (ex: e-customs system) (MT)
3. Digital Financial Services	**Foster digital payments as a key entry point for digital financial services:** i. Transition adults and firms making or receiving payments in cash to digital payments as an entry point to digital financial services and the digital economy (MT). ii. Consider additional mechanisms to incentivize e-wallet usage (ST). iii. Enhance the use of alternative data to support enhanced decisions by industry (MT).
4. Digital literacy and advanced digital skills	**Enhance digital skills to support a more efficient and effective private and public sector:** i. Target digital literacy training to specific groups such as youth and those in 'last mile' areas in order to narrow the skills gap. (ST) ii. Improve accessibility and relevance of public support to develop digital skills for the workforce (ST). iii. Support greater digital financial literacy through targeted interventions (ST). iv. Foster investments in digital skills across the public sector to maximize the benefits of GovTech transformation (MT)
5. Digital safeguards	**Mitigate some of the main risks to the digital economy:** i. Build strong systems for digital identification and authentication, including eKYC and eKYB (ST) ii. Strengthen the legal and regulatory framework for data privacy, including going beyond the proposed amendments to the 2010 Personal Data Protection Act (PDPA) (ST). iii. Strengthen consumer protection for digital financial services: through enactment of the Consumer Credit Act proposal (2022) (ST), a single window for consumer complaints (MT). and increased use of alternative dispute mechanisms (MT). iv. Reduce fragmentation in the legal framework for cybersecurity (MT)

World Bank staff interpretations
Note: ST=short-term, MT=medium-term

PART ONE

Recent economic developments and outlook

Recent Economic Developments

Marked slowdown in advanced economies growth, while regional growth rebounded

Three years after emerging from the pandemic-induced recession of 2020, global growth has slowed markedly, edging closer to falling into recession. Advanced-economy growth slowed from 5.3 percent in 2021 to an estimated 2.5 percent in 2022, the fourth fastest deceleration of the past 50 years.[8] Economic conditions deteriorated substantially in H2 2022 as persistent high inflation eroded the purchasing power of households and dented confidence. High inflation has triggered unexpectedly rapid and synchronous monetary policy tightening around the world, including across major advanced economies. This has contributed to a significant worsening of global financial conditions, which is exerting a substantial drag on economic activity. This drag is set to deepen given the lags between changes in monetary policy and its economic impacts, with real rates expected to continue to increase.

Excluding China, growth in the East Asia and Pacific (EAP) region rebounded as mobility restrictions were removed. Growth for the region is estimated to be at 3.2 percent, 1.2 percentage point below previous forecasts earlier in June 2022. The slowdown was almost entirely due to China, which accounts for around 85 percent of the region's GDP, where growth slowed sharply to 2.7 percent (June 2022: 4.3 percent). Excluding China, the pace of growth doubled, rising to 5.6 percent in 2022. Growth was supported by a release of pent-up demand as many countries continued to lift pandemic-related mobility and travel restrictions. Meanwhile, consumer price inflation increased across the region in 2022. While it has remained below or close to central bank targets in China and Vietnam, it has exceeded targets for several months in other countries, including Indonesia, the Philippines and Thailand, mainly reflecting increases in energy and food prices.

8 See The World Bank Global Economic Prospects, December 2022.

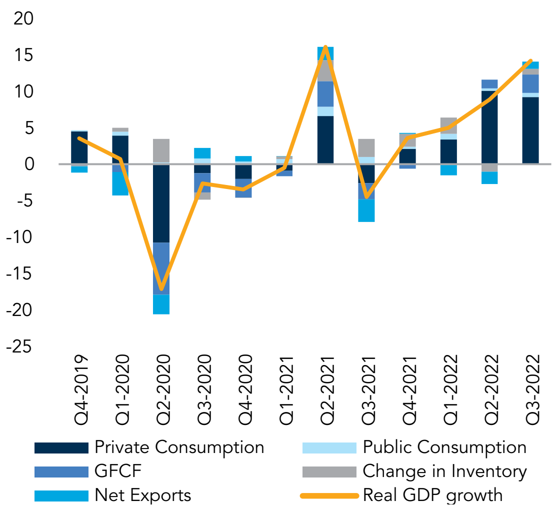
Developments in the Malaysian Economy

The momentum in Malaysia's economic recovery continued in Q3 2022

The Malaysian economy recorded a strong growth of 14.2 percent (YoY) in Q3 2022 (Q2 2022: 8.9 percent) (Figure 1). Malaysia's growth during the quarter was also the highest relative to other regional countries (Figure 2).[9] Growth was largely driven by a continued increase in domestic demand in addition to sizeable base effects. During the period, private consumption grew at 15.1 percent (Q2 2022: 18.3 percent) as labor market conditions continued to improve. In addition, the increase in the minimum wage from RM1,200 to RM1,500 as well as cash assistance programs such as *Bantuan Keluarga Malaysia* and withdrawals from the Employee Provident Fund (EPF) also lend support to consumer spending. Meanwhile, higher capital spending in both the private and public sectors contributed to further improvements in investment activity. Gross fixed capital formation (GFCF) increased by 13.1 percent (Q2 2022: 5.8 percent). The external sector remained supportive of economic activity on high external demand and higher commodity prices. Gross exports grew by 38.3 percent (Q2 2022: 29.9 percent), led by the electrics and electronics (E&E) sector. On a quarter-on-quarter seasonally adjusted basis, the economy grew by 1.9 percent (Q2 2022: 3.5 percent).

FIGURE 1
Malaysia's economy recorded a strong growth in Q3 2022.

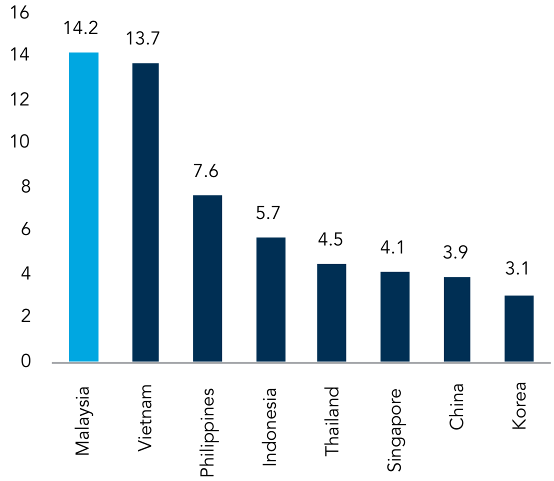
Contribution to GDP growth and Real GDP growth, y/y percentage



Source: DOSM

FIGURE 2
Malaysia's growth was also the highest relative to other regional countries.

Annual growth, y/y, percentage



Source: DOSM, Haver

9 GDP growth for regional countries (y/y) - Vietnam: 13.7 percent; Philippines: 7.6 percent; Indonesia: 5.7 percent; Thailand: 4.5 precent.

On the supply side, all economic sectors expanded in Q3 2022. The services sector expanded by 16.7 precent (Q2 2022: 12.0 percent) on improved labor market conditions and continued recovery in consumer-related segments such as retail and leisure-related services (see Box 1: The Results from the Business Pulse Survey (BPS) in August 2022). Meanwhile, the manufacturing sector grew by 13.2 percent (Q2 2022: 9.2 percent), led by the E&E cluster. The mining sector recorded an expansion of 9.2 percent (Q2 2022: -0.5 percent), on higher oil and gas output. The rebound in the construction sector, which expanded by 15.3 percent (Q2 2022: 2.4 percent) was attributed to broad-based expansion in the non-residential subsectors including in commercial real estate, mixed-development, and small-scale projects. In the agriculture sector, output grew by 1.2 percent (Q2 2022: -2.4 percent), driven mainly by higher oil palm output as labor shortages eased and yields increased. On level terms, output for the agriculture, manufacturing and services sectors have returned to its pre-pandemic levels (December 2019). The construction sector output remains quite significantly below its pre-pandemic level, while the mining sector output is almost back at the level prior to the pandemic.

TABLE 1
GDP growth decomposition

GDP, y/y, Percentage

	2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020	2020	Q1 2021	Q2 2021	Q3 2021	Q4 2021	2021	Q1 2022	Q2 2022	Q3 2022
GDP	**4.4**	0.7	-17.1	-2.5	-3.3	**-5.5**	-0.5	15.9	-4.5	3.6	**3.1**	5.0	8.9	14.2
Consumption														
Private Sector	**7.7**	6.8	-18.4	-1.9	-3.3	**-4.2**	-1.5	11.7	-4.2	3.7	**1.9**	5.5	18.3	15.1
Public Sector	**1.5**	5.0	2.4	6.8	5.4	**5.0**	5.6	8.2	7.1	1.6	**5.3**	6.7	2.6	4.5
Gross Fixed Capital Formation	**-2.1**	-4.4	-29.0	-11.4	-11.7	**-14.4**	-3.3	16.4	-10.8	-3.0	**-0.9**	0.1	5.8	13.1
Exports of Goods & Services	**-1.0**	-7.0	-21.5	-4.2	-1.9	**-8.6**	11.7	37.1	4.2	13.0	**15.4**	8.0	10.4	23.9
Imports of Goods & Services	**-2.4**	-1.9	-18.5	-7.8	-3.4	**-7.9**	12.2	35.5	11.4	14.5	**17.7**	11.1	14.0	24.4
Sectoral														
Agriculture	**1.9**	-8.8	0.6	-0.5	-1.2	**-2.4**	0.1	-1.5	-2.0	2.8	**-0.2**	0.1	-2.4	1.2
Mining	**-0.6**	-2.9	-19.2	-6.6	-9.8	**-9.7**	-4.4	10.6	-3.2	-0.6	**0.3**	-1.1	-0.5	9.2
Manufacturing	**3.8**	1.4	-18.4	3.2	3.0	**-2.7**	6.7	26.7	-0.8	9.1	**9.5**	6.6	9.2	13.2
Construction	**0.4**	-7.9	-44.3	-12.2	-13.7	**-19.3**	-10.4	40.3	-20.6	-12.2	**-5.2**	-6.2	2.4	15.3
Services	**6.2**	3.2	-16.2	-3.9	-4.6	**-5.4**	-2.3	13.4	-4.9	3.2	**1.9**	6.5	12.0	16.7

Source: DOSM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BOX 1

The Results from the Business Pulse Survey (BPS) in August 2022 Show Recovery Taking Root with International Borders Reopening

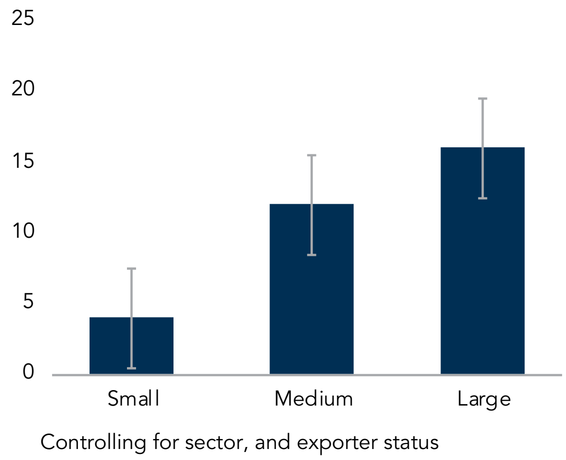
Firms have shown continuous recovery in operational status and sales. While firms' operational status has improved as they are operating nearer to full capacity, small firms on average are still operating below full capacity that is slightly lower than the operational capacity of medium and large-sized firms (Figure 3). Recovery is broad-based with firms of all sizes and across all sectors achieving positive changes in sales relative to the same period pre-pandemic. Nonetheless, large firms still lead the way in sales growth following the re-opening of international borders on April 1, 2022.

Digitalization remains the most popular adjustment strategy for firms. This is evident with investments in new equipment, software or digital solutions are increasing post-pandemic with the average investments in digital technology by firms, rising from RM1.5 million (approximately US$390,000) in 2019 to RM1.9 million (approximately US$460,000) in the past 12 months. More encouragingly, investments are shifting into more advanced business functions over customer-facing functions. 54 percent of firms invest in production technologies, over 46 percent of firms investing in marketing and 31 percent in online sales (Figure 4). Investments in more advanced business functions, such as production technology are largely driven by mid-size (62 percent) and large firms (60 percent). However, small-sized firms largely invest in business administration (at 42 percent of firms), at the same level as those investing in marketing and customer relations (which was also the most popular investment for small firms in Jan-Feb 21 by a large margin).

FIGURE 3

Sales have reverted to positive figures with large firms leading sales growth following international re-opening.

Average change in sales during past 30 days compared to 1Q 2022, percentage

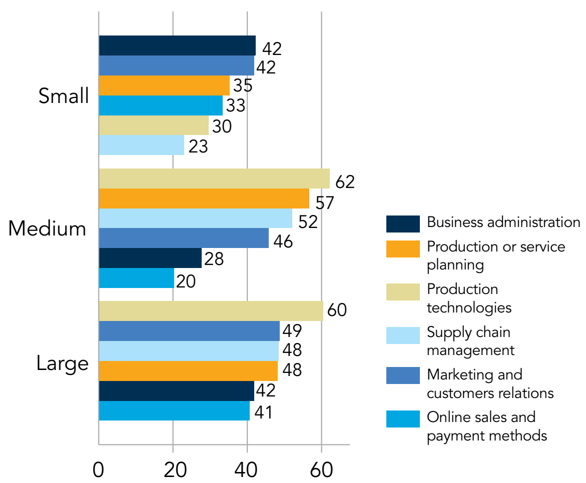


Source: World Bank Business Pulse Survey August 2022

FIGURE 4

Investments are shifting into more advanced business functions over customer-facing functions.

Share of firms who invest in new equipment software or digital solutions in the past 12 months, percentage



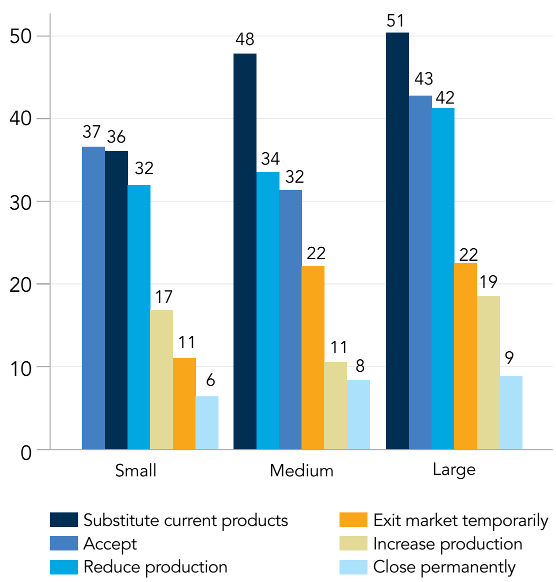
Source: World Bank Business Pulse Survey August 2022

Firms also face new trends amidst international re-opening and recent global development. The overall rise in costs affects a substantial proportion of firms where 43 percent of firms experienced increased input costs compared to the pre-pandemic level, with an average increase in costs of 12 percent. Additionally, most firms (56 percent) have felt that market competition had intensified within the last 12 months. Overall, with rising volatility in input costs and an environment of monetary policy adjustments, there have been changes in firms' perception towards ending government support programs. The share of firms that perceive the end of government support to be harmful has increased from 13 percent in February 2022 to 20 percent in August 2022. Correspondingly, the proportion of respondents that perceived such government support is not needed for recovery has dropped from 33 percent to 27 percent.

With rising prices internationally, the Malaysian government has deployed price control as a policy tool much more extensively to cap prices relative to other countries in the region. Close to half of the firms surveyed (49 percent) being affected by price controls. Extensive use of price control over a long period distorts the market and ironically, may exacerbate the shortages of the product in question. Out of the firms reportedly affected by the price control, 37 percent of firms say they reduce production by an average of 24 percent. Furthermore, the survey found that the burden of price controls falls disproportionately on smaller firms as compared to medium and large-sized firms that could pivot away from price-controlled products (Figure 5).

FIGURE 5
Burden of price controls falls disproportionately on smaller firms as compared to medium and large-sized firms.

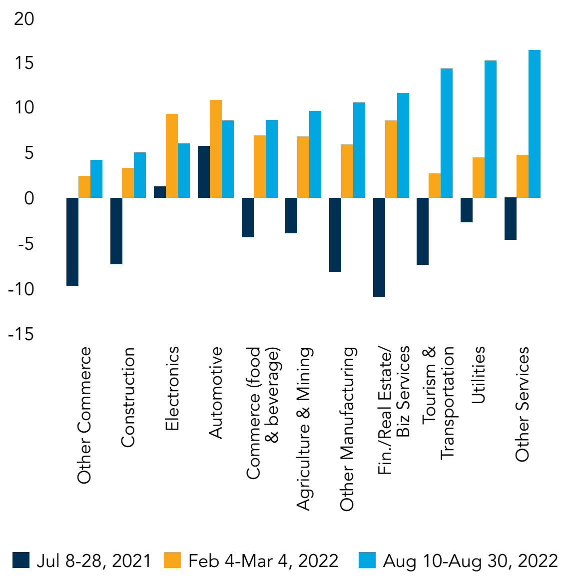
Share of affected firms plan to deal with price controls, percentage



Source: World Bank Business Pulse Survey August 2022

FIGURE 6
Firms' expectations for sales are optimistic for the next three months.

Share of firms expected change in sales in the past 12 months, percentage



Source: World Bank Business Pulse Survey August 2022

Despite new trends and challenges, firms' expectations for sales are optimistic for the next three months. The proportion of firms that expect sales to increase in the next three months relative to the same period last year increased from 34 percent to 38 percent from the fourth round to the most recent fifth round of the BPS.

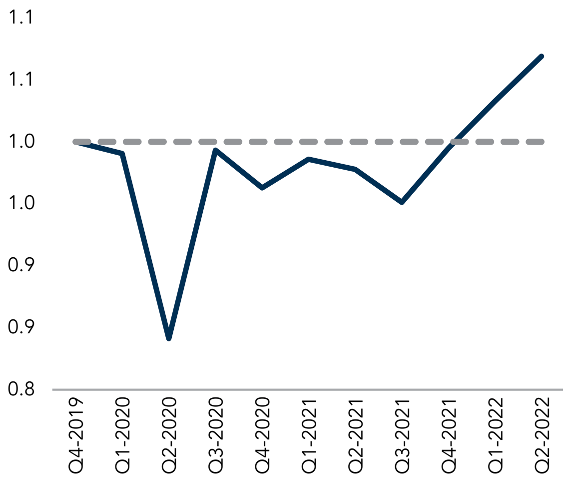
Additionally, firms in the tourism and transportation sector have the third most optimistic outlook in August 2022 buoyed by the reopening of the international border while firms in the electronics and automotive sectors have adjusted their sale growth outlook compared to the prior round (Figure 6).

While output has surpassed its pre-pandemic level, it remains below the pre-pandemic projected level (Figure 7 and Figure 8). As of Q3-2022, output losses in Malaysia were estimated at 16.2 percent of GDP (2019).

But thus far, the economic recovery has been strong, surpassing expectations. Since April, the growth forecast has trended upward in the consensus forecast.

FIGURE 7
GDP has surpassed its pre-pandemic level…

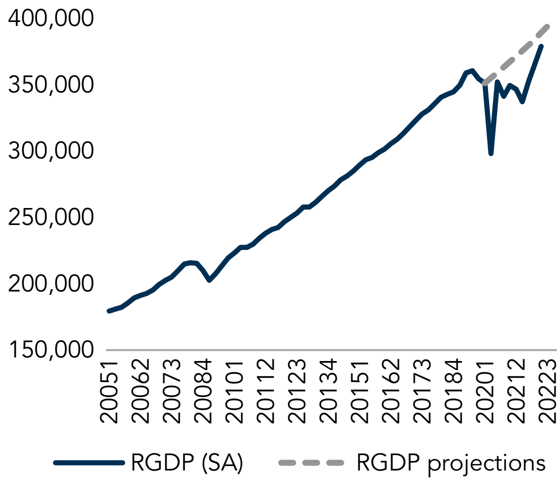
RGDP relative to Q4-2019 RGDP, percentage



Source: Haver Analytics and World Bank Staff Calculations

FIGURE 8
…however, it remains below its pre-pandemic projected level.

GDP seasonally adjusted, RM million (2015)



Source: Haver Analytics and World Bank Staff Calculations
Note: The projections (2020, 2021) are based on the forecast in the Malaysian Economic Monitor of December 2019. For 2022, the projected growth rate is the 5-year average, as of December 2019.
Since GDP growth forecasts are annual, it is assumed equal growth rate in all quarters.

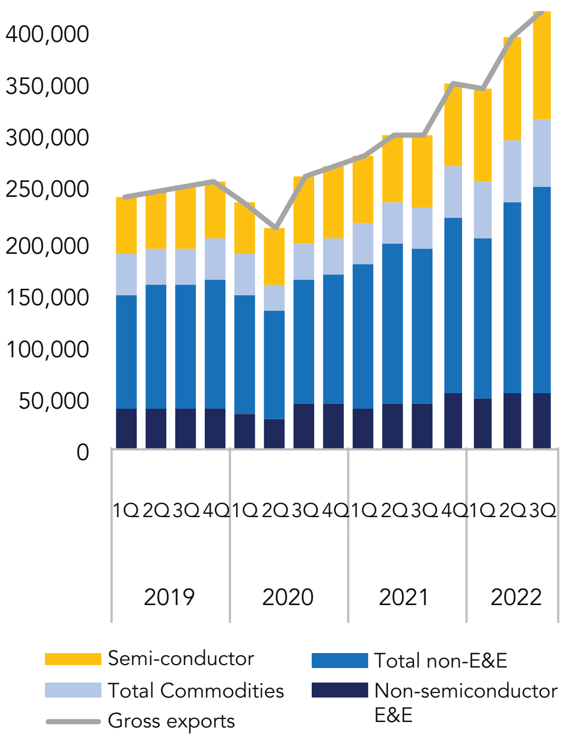
Higher exports growth was supported by stronger external demand

Strong external demand for E&E and non-E&E products led to higher gross exports in Q3-2022 (Figure 9). Gross exports expanded faster in Q3 2022 at 38.3 percent (Q2 2022: 29.9 percent), underpinned by a broad-based increase in external demand across all products and by higher commodity prices. A stronger external demand for E&E products led to a faster increase in manufacturing exports, and higher exports of petroleum products, palm-oil based, and metal manufactured products supported an expansion of non-E&E exports. Similarly, gross imports expanded faster in Q3 2022 at 46.5 percent (Q2 2022: 36 percent), following an increase in intermediate goods imports in line with the increase in manufacturing exports. Machinery and transport equipment, and mineral fuels/lubricants contributed the most to the import growth. Consumption imports increased in line with the stronger private consumption. On balance, the current account recorded a slightly higher surplus of 3.1 percent of GDP during the quarter (Q2 2022: 1.0 percent) (Figure 10).

FIGURE 9

Gross exports continues to expand due to strong demand for both E&E and non-E&E products.

Gross export growth, RM million

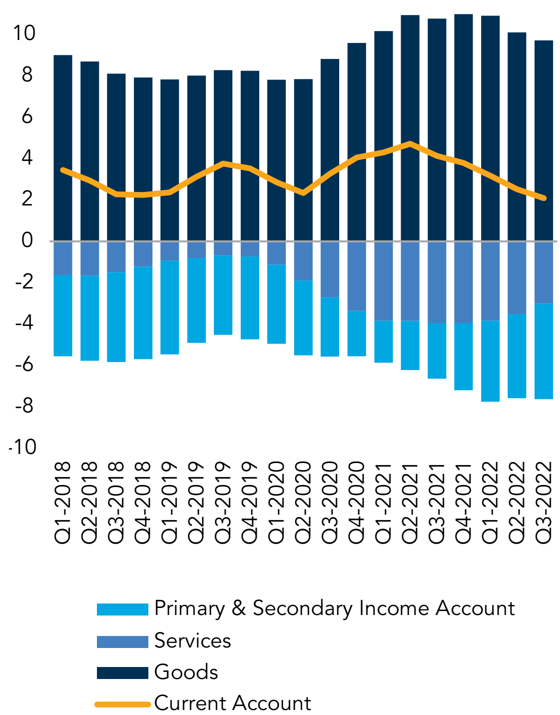


Source: World Bank staff calculations based on BNM and DOSM data

FIGURE 10

On balance, the current account recorded a slightly higher surplus of 3.1 percent of GDP during the quarter.

Percentage of GDP, 4-quarter rolling average



Source: World Bank staff calculations based on BNM and DOSM data

Despite a strong export performance, the real effective exchange rate (REER), continues to decrease (Figure 11).[10] Unlike several countries in the region, Malaysia's REER has been on a downward trend since Q2 2018 (Figure 12), depreciating by almost 8 percent between Q2 2018 and Q3 2022. One contributing factor to the decline in the REER is the persistent portfolio capital outflows during this period.

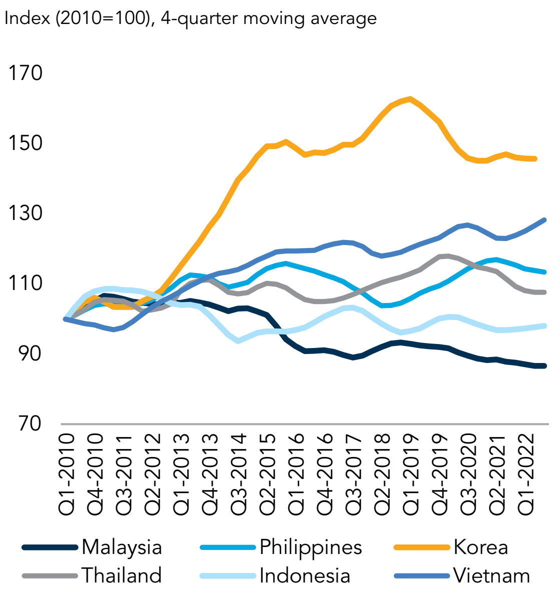
FIGURE 11

Export competitiveness, as measured by the real effective exchange rate (REER), continues to improve.

Source: IMF International Financial Statistics (IFS)

FIGURE 12

Unlike other regional countries, Malaysia's REER has been on a downward trend since Q2 2018.



Source: IMF IFS, Bank of Thailand, and Haver
Note: REER for Korea is based on unit-labor cost.
REER for Thailand is from the Bank of Thailand

TABLE 2

Selected external sector indicators

	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022
Balance of Goods & Services (% of GDP)	5.5	3.7	8.1	7.6	5.9	6.8	6.9	8.5	6.1	4.9	7.3
Current Account Balance (% of GDP)	2.2	1.9	7.2	5.0	3.2	3.6	4.8	3.6	0.7	1.0	3.1
Total Exports of Goods and Services (% of GDP)	61.0	60.9	61.5	62.8	66.3	71.3	68.4	69.4	69.4	73.9	77.3
Total Imports of Goods and Services (% of GDP)	55.5	57.2	53.4	55.2	60.4	64.4	61.4	60.8	63.3	69.0	70.0
Net Portfolio Investment (RM billion)	-41.6	20.6	-20.7	-7.8	-0.2	20.1	-3.7	2.6	-10.1	-14.7	0.1
Gross Official Reserves (RM billion)	**440.1**	**443.1**	**436.5**	**432.4**	**451.1**	**461.6**	**482.5**	**486.8**	**485.8**	**480.1**	**492.0**
(US$ billion)	**101.7**	**103.4**	**105.0**	**107.6**	**108.6**	**111.1**	**115.2**	**116.9**	**115.6**	**109.0**	**106.1**

Source: World Bank staff calculations based on DOSM data

10 The REER is a more appropriate measure of external competitiveness, compared to bilateral exchange rates since the REER is the weighted average of the bilateral real exchange rates between the country and all its trading partners. The weights are the respective trade shares of each partner.

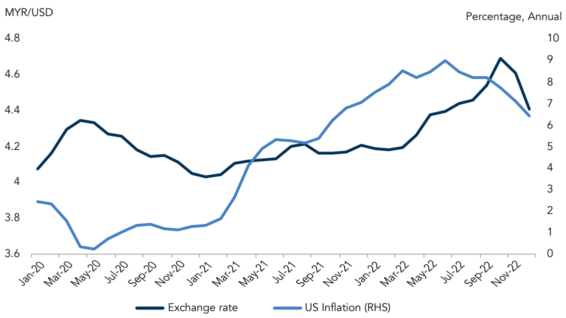
BOX 2

Currency Depreciation in Malaysia could have a Positive Spillover Effects on Real GDP Through Higher Exports

The Federal Reserve (Fed) response of raising interest rates to stem inflation in the US has led to capital outflows and currency depreciation in emerging market economies such as Malaysia. The Fed raised the federal funds rate by 225 basis points in total since March 2022 and is expected to tighten its monetary policy further before the end of the year. The policy change has had a direct impact on emerging market economies. In Malaysia for instance, the nominal exchange rate went from a monthly average of 4.19 ringgit per US dollar in January 2022 to 4.55 in September 2022, implying a depreciation of 8.5 percent.

FIGURE 13

The ringgit depreciated by 1.7 percent against the US dollar between January and July 2022.

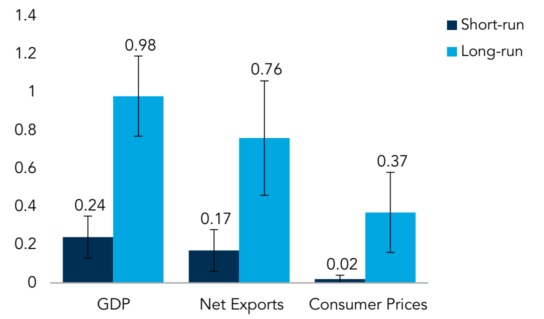


Source: World Bank staff calculation

FIGURE 14

The ringgit depreciation against the US dollar could have a positive spillover impact on output, net exports, and consumer prices.

Change, percentage



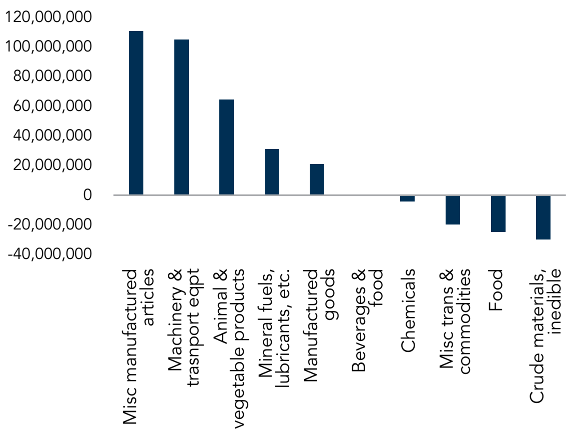
Source: World Bank staff calculation

Using quarterly data, we estimate the effect of ringgit depreciation on economic growth, net exports, and consumer price index in both the short- and long- run. On the one hand, these results suggest that a depreciation of the ringgit could lead to an increase in the cost of living as imported goods and services in consumer's basket rise. But on the other hand, the depreciation could be favorable for economic growth through an increase in the country's international competitiveness and net exports. New empirical findings suggest that, in the long run (short run), a ringgit depreciation of 1 percent against the US dollar is associated with a 1 percent (0.2 percent) increase in real GDP; a 0.8 percent (0.2 percent) increase in real net exports; and a 0.4 percent (0.0 percent) increase on prices.

FIGURE 15

Manufacturing and machinery sector is estimated to experience largest gain from ringgit depreciation.

RM million

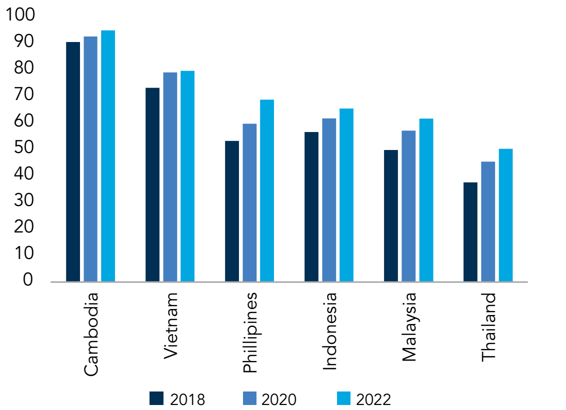


Source: World Bank staff calculation

FIGURE 16

The ringgit depreciation against the US dollar could have a positive spillover impact on output, net exports, and consumer prices.

Change, percentage



Source: World Bank staff calculation

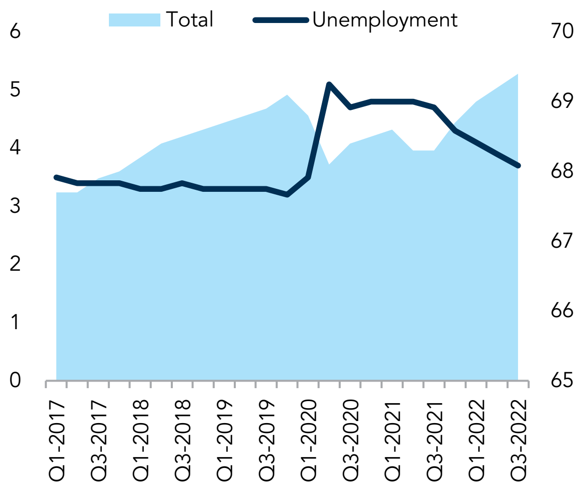
In sum, Malaysia's economic performance would likely not be negatively affected by the ringgit depreciation against the US dollar. While currency depreciation could be interpreted as a weakening of the ringgit against the US dollar, this is a global phenomenon which has affected other emerging markets. Therefore, the success of the Malaysian economy relative to other emerging economies still depends on fundamentals rather than nominal variables. Moreover, our analysis shows that if the depreciation persists this could benefit the Malaysian economy in the long run through the competitiveness channel.

Labor market conditions are gradually returning to those seen prior to the pandemic

The labor market continues to recover following the lifting of all mobility restrictions imposed during the COVID-19 pandemic (Figure 17). Although it has not return to its pre-pandemic levels, the unemployment rate declined both overall and by age group. The unemployment rate has decreased to 3.7 percent in Q3 2022 (Q2 2022: 3.9 percent). At the same time, labor force participation rose by 0.2 percentage points to 69.4 percent in Q3 2022 (Q2 2022: 69.2 percent). The unemployment rate for youth aged 15-24 remains high, at 10.8 percent in Q3 2022, three times higher than the national unemployment rate. While not uncommon globally, it is still of concern (Figure 18). Meanwhile, the unemployment rate for those aged 55-64 shows substantial improvement from the pandemic declining from 4 percent in Q3 2021 to 1.3 percent in Q3 2022. This substantial fall may be partly due to the decrease in labor force participation among workers in the 55-64 age group, though economic recovery has no doubt also played a role.

FIGURE 17
Recovery in the labor market continues as mobility restrictions were lifted.

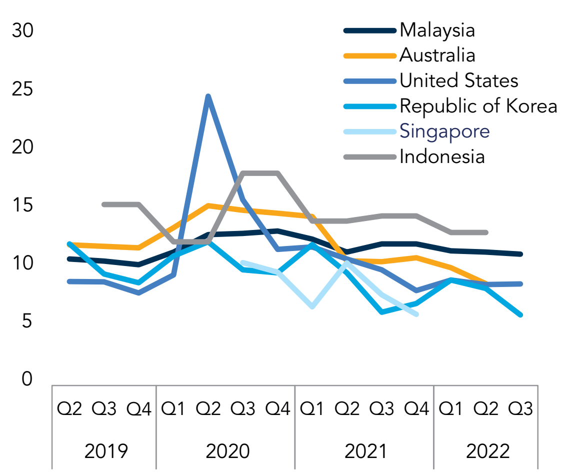
Unemployment rate, labor force participation rate, percentage



Source: DOSM

FIGURE 18
While not uncommon, the high youth unemployment rate is still of concern.

Youth unemployment rate, percentage



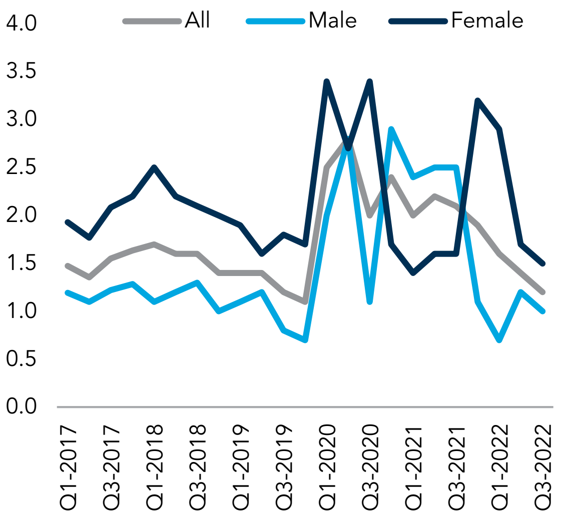
Source: DOSM
Note: The youth unemployment rate refers to the unemployment rate among workers aged 15 to 24

Patterns in labor force participation among older persons and youth changed during the pandemic and are gradually reverting to pre-pandemic levels. The pandemic resulted in an increase in labor force participation rate amongst those aged 55-64, rising from 46.9 percent (Q4 2019) to 51.4 percent in Q1 2020, and remaining relatively high throughout 2020 before gradually declining in 2021. In contrast, labor force participation among youth aged 15-24 declined during the pandemic, from 45.9 percent in Q4 2019 to 42.4 percent in Q4 2020 and have since been on the rise again to 45.7 percent in Q3 2022. A potential explanation for these patterns of labor force participation is that during the pandemic, older workers were forced to return to the labor force to support their households, whose younger members may have lost their jobs. At the same time, youth with poor employment prospect may have dropped out of the labor force during the pandemic.

Both time-related and skills-related underemployment[11] are declining; however, there are likely different reasons behind the declines. The decline is more rapid for time-related underemployment, suggesting that it is more likely driven by cyclical factors. In the case of skills-related underemployment, structural factors appear to also play a role, with an upward trend in skills-related underemployment evident even prior to the pandemic (Figure 19 and Figure 20). Structural factors that contribute to skills-related underemployment refer to the potential drivers of mismatch between the skills demanded by employers and the skills that workers have, such as the lack of demand for tertiary educated workers given the subject area of their educational background, or lack of other types of skills, such as soft skills. For example, the Productivity and Investment Climate Survey (PICS-3)[12] conducted in 2019-2020 found that more than half (55.7 percent) of firms reported difficulty in finding employees with interpersonal and communication skills, and 44.7 percent of firms reported difficulty in finding employees with problem solving or critical thinking skills. The time-related underemployment rate reached 1.2 percent in Q3 2022, which is the same as the rate seen pre-pandemic (in Q3 2019). The skills-related underemployment rate in contrast remains high, at 36.8 percent in Q3 2022, which is only modestly lower than that experienced during the pandemic. Active labor market policies are one tool that can help to address labor mismatches (see Box 3: Global Best Practices in Active Labor Market Policies).

FIGURE 19
Time-related underemployment has returned to its pre-pandemic level...

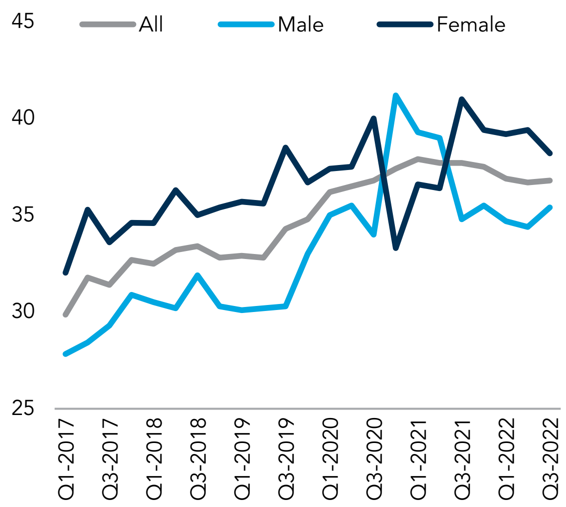
Time-related underemployment, by gender, percentage



Source: DOSM
Note: The time-related underemployment rate reflects the share of workers employed for less than 30 hours per week due to the nature of their work or to the insufficient availability of work.

FIGURE 20
...while skills-related underemployment remains relatively high.

Skills-related underemployment, by gender, percentage



Source: DOSM
Note: The skills-related underemployment rate is the share of workers with tertiary qualification who are employed in semi-skilled or low-skilled jobs.

11 Time-related underemployment rate is the share of workers employed for less than 30 hours per week due to the nature of their work or to the insufficient availability of work. The skills-related underemployment rate is the share of workers with tertiary qualification who are employed in semi-skilled or low-skilled jobs.

12 The PICS-3 is a firm survey conducted by the World Bank that enables the assessment of firms' performance across Malaysia, and the constraints that they face in their operations. It surveyed 1,412 manufacturing and services firms across Malaysia in 2019-2020.

BOX 3

Global Best Practices in Active Labor Market Policies

Policymakers can employ a broad range of active labor market policies (ALMPs) and services that can address constraints and challenges faced by the labor force, including – but not limited to – unemployment and underemployment. ALMPs work best when they target specific constraints that hold back jobseekers, such as a lack of jobs, a lack of information or access to jobs, or a lack of skills. They have the potential to: (1) enhance the capabilities and human capital of jobseekers (through skill development and training programs), (2) extend the set of opportunities accessible to jobseekers (through job search assistance, matching, wage subsidies, and entrepreneurship training), and (3) improve the motivation to work (through counselling, wage subsidies, and job matching) (OECD 2013).

During COVID-19, ALMPs were used to retain employment (and prevent excessive unemployment), as well as to support hiring and rehiring. These same policies allowed workers to maintain their income and provided flexibility in the employer-worker relationship. The four main types of ALMPs implemented were: (1) wage subsidies, (2) labor market regulations, (3) shorter work time arrangements, and (4) training and placement assistance. Globally, 84 percent of countries implemented such policies. In Malaysia, a range of ALMPs were used during the pandemic, including wage subsidies and skills training programs, including those provided by the Employment Insurance System (EIS) and e-LATIH, administered by the Human Resource Development Corporation (HRDCorp).

Malaysia now has a significant range of programs supporting the labor market, which can benefit from strengthened coordination and monitoring and evaluation. In 2022, the government implemented an initiative called *JaminKerja*, which included a broad suite of ALMPs: wage subsidies, upskilling and reskilling, and a job guarantee program (referred to as MySTEP). Despite these commendable efforts, there remains to be challenges in the provision of ALMPs in Malaysia, one of which is fragmentation. Skills training programs are administered by over 70 agencies. This fragmentation creates inefficiencies in the administration and delivery of the programs. There is also a need to monitor and evaluate programs that are implemented. For example, it would be important to analyze both the short- and long-term outcomes of the wage subsidy program implemented during the pandemic to be able to draw lessons for the implementation of future programs, and to ensure that the program is meeting its objectives.

Going forward, digitalization of ALMP services and the use of artificial intelligence (AI) will be a key aspect of delivering more comprehensive, accessible, and effective services. AI can be used to elevate profiling tools to identify and target vulnerable jobseekers, to match available labor demand and supply and identify skills gaps in labor markets, and to improve the identification of vacancies and outreach to employers. For example, the Republic of Korea has employed various advanced methodologies (including ontology, network analysis, and deep learning) to create a tool that recommends and provides information on services tailored to each individual jobseeker, including suitable job openings and training programs (OECD 2022).

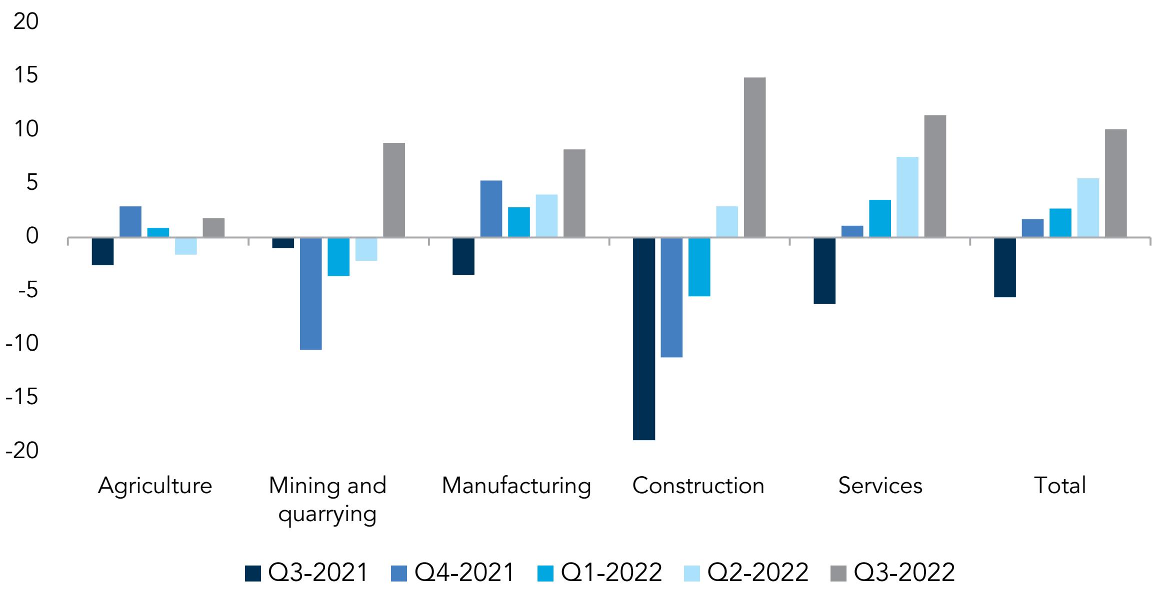
There are large gender differences in both time- and skills-related underemployment during the pandemic. Prior to Q3 2020, both types of underemployment were generally higher for women. Between Q4 2020 and Q3 2021, this was reversed, with the rate of underemployment being higher among men compared to women. While the exact reasons cannot be ascertained using publicly available statistics, one potential reason for the decrease in time-related underemployment for women during the pandemic may be due to rising care responsibilities, which decreased women's willingness and ability to work more hours. Data for 2019-2021 shows an increase in the number of women outside of the labor force who are engaged in housework/family responsibilities. In contrast, some men who lost full-time jobs may have been forced to move into part-time employment, whilst being willing to work more hours. For skills-related underemployment, a possible explanation is that women who were underemployed may have been more likely to have lost their jobs, whereas men in high-skilled employment who lost their jobs during the pandemic may have been forced to move into mid- or low-skilled jobs (which are also more likely to be part-time, as mentioned above). Further analysis is needed to better understand what is behind these trends; what is clear, is that the employment impact of the pandemic was very different for men and women.

Growth in productivity and employment continue to increase overall led by the services and manufacturing sectors. Labor productivity has been rising from -5.6 percent in Q3 2021 to 10.1 percent in Q3 2022 (Figure 21). There are, however, differences in performance between sectors. The construction sector saw the greatest improvement in labor productivity at 14.9 percent (Q3 2021: -18.9 percent). This is followed by the services sector, where labor productivity increased by 11.4 percent (Q3 2021: -6.2 percent). Within the services sector, the highest growth in productivity was registered by food and beverages and accommodation, real estate and business services and transportation and storage. The mining and quarrying and manufacturing sectors also saw marked improvements in labor productivity, while the agriculture sector reported a slight increase of 1.8 percent. Overall, employment increased by 3.6 percent in Q3 2022 (Q2 2022: 3.2 percent) (Figure 22). Services has seen the largest increase in employment of 4.8 percent (Q2 2022: 4.2 percent), followed by manufacturing, which grew by 4.5 percent (4.9 percent). The general increase in labor productivity and employment have largely occurred in correspondence to the reopening of the economy since Q3 2021.

FIGURE 21

Economic recovery is evident in labor productivity…

Change in Labor Productivity year-on-year, by sector, percentage

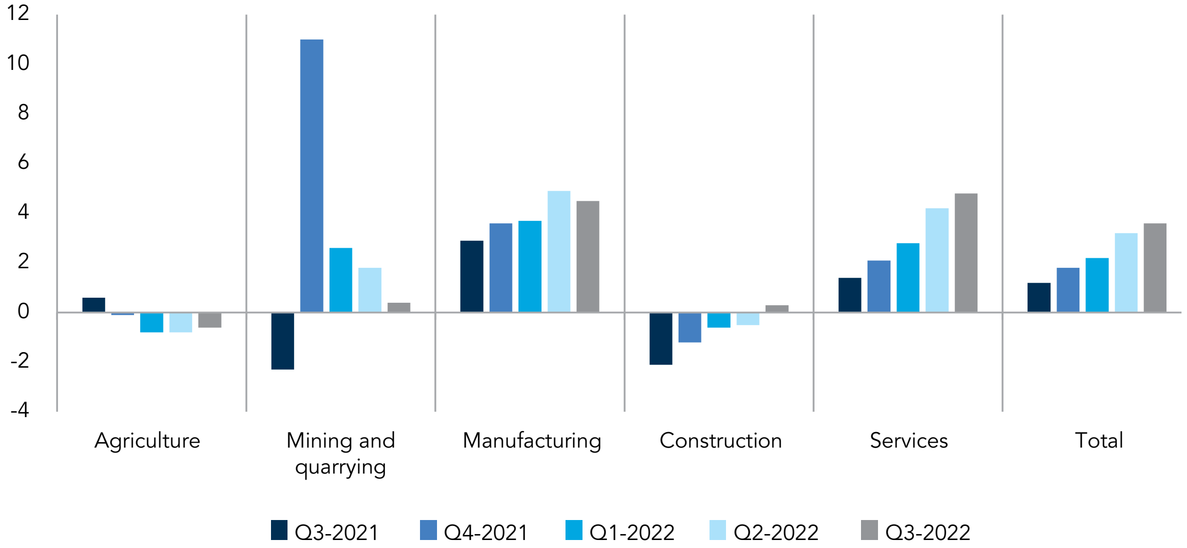


Source: DOSM

FIGURE 22

…as well as employment.

Change in employment year-on-year, by sector, percentage



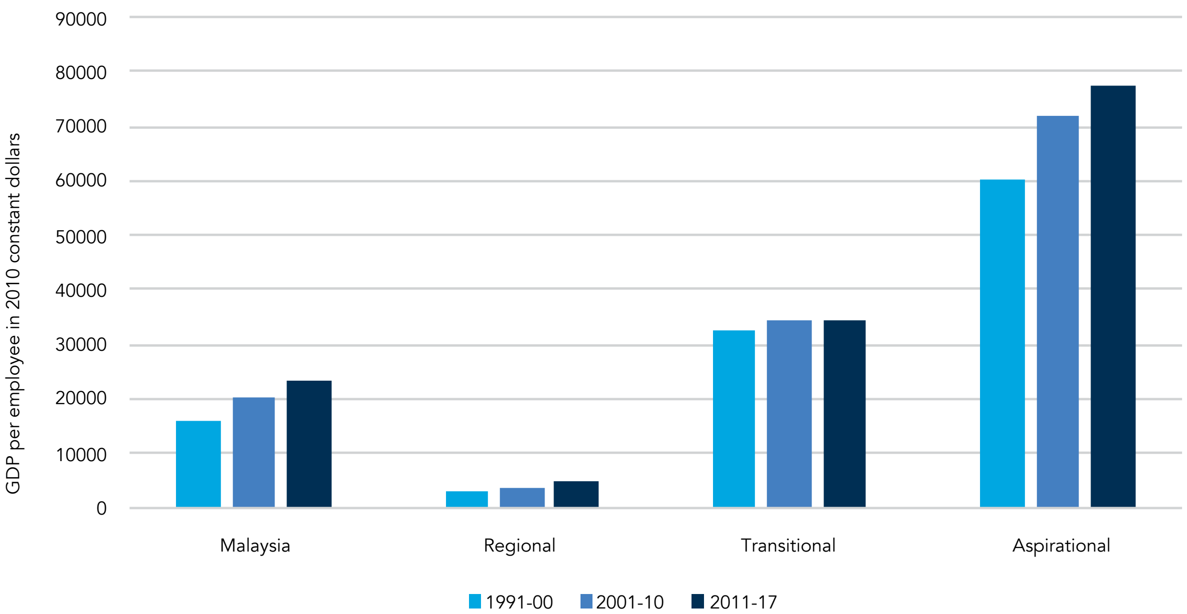
Source: DOSM

Despite the recent recovery, there is still significant room for improvements in labor productivity when comparing Malaysia and the aspirational set of comparator countries. The level of labor productivity in Malaysia is above that of regional comparators and displays a convergence with transitional comparators. However, it remains significantly behind aspirational comparators (Figure 23).

FIGURE 23

Malaysia's labor productivity level trailed comparators even before the pandemic

Labor productivity level, GDP per employment in 2010 constant dollars



Source: World Bank Enterprise Survey (2019)

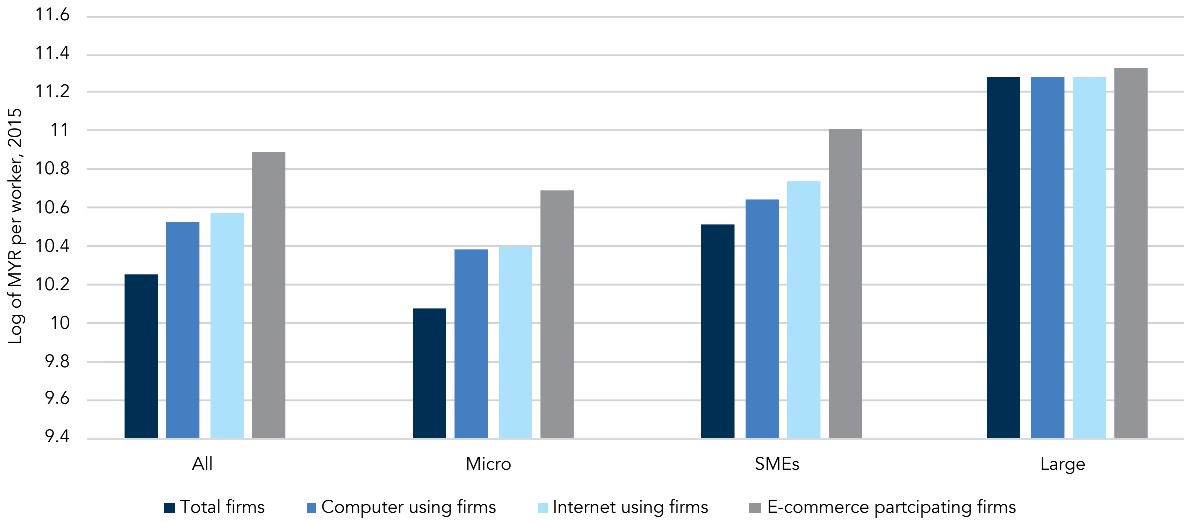
Note: The regional group consists mainly of ASEAN peers, while the transitional peer group consists of countries that achieved high-income status in the last 30 years (1988–2017). The aspirational group consists mainly of OECD member countries.

In addition, while there has been improvements in the labor markets, total factor productivity (TFP) continues to lag, following a pre-pandemic trend. In 2019, Malaysia's pace of productivity growth had slowed noticeably, partly reflecting weakening external demand, with growth below the averages for upper-middle-income comparators worldwide. A similar pattern was observed when comparing Malaysia's TFP trends with higher income economies in the East Asia and Pacific (EAP) region.[13] A recent IMF paper noted that digitalization is a key driver of TFP, particularly for Asian countries like Malaysia.[14]

Digitalization offers firms ways to use resources more efficiently, and support gains in productivity. Data from OECD Economic Surveys Malaysia (2021) in World Bank 2022c, firms in the services sector that uses digital technology especially firms that participate in e-commerce firms have higher level of labor productivity (Figure 24). Moreover, the differences between firms that uses the digital tools compare to those that does not are most pronounced in the micro and SMEs categories. (World Bank, 2022c). Digitalization of production processes can increase the efficiency of specific tasks, leading to gains in overall productivity. The pandemic boosted digitalization in the region, presenting a potential upside for productivity growth corresponding to the need to reduce in-person interactions and enhance social distancing experiences during the pandemic (Figure 24).[15]

FIGURE 24
Services firm that uses digital tools experience higher levels of productivity

Labor productivity by firm size with/without digital tools



Source: DOSM, Economic Census 2011 and 2016 in OECD Economic Surveys - Malaysia (2021) in World Bank 2022c.

Despite an impressive economic rebound across the board in 2022, the World Bank's High-Frequency (HiFy) Phone Survey Round 3[16] in Malaysia found that recovery continued to be slower among poor and vulnerable groups. As of May 2022, households with lower incomes, young workers, those with low education, as well as business owners and informally employed workers tend to continue experiencing economic shocks. Work stoppages among pre-pandemic lower-income workers stood at 25 percent compared with 15 percent among their higher-income peers. Moreover, nearly 70 percent of lower-income households self-assessed themselves as having inadequate financial resources to meet their monthly basic needs, and more than 60 percent of these households reported having no savings. The slower return of poor and vulnerable households to work, and the depletion of their financial resources, makes their recovery more challenging.

The lingering effects of the pandemic on poor households have been further intensified by the recent increases in food and energy prices. The HiFy surveys continued to suggest that the prevalence of food insecurity remained significantly higher among lower-income households. This slower progress in recovery from the pandemic impacts has been exacerbated by

13 World Bank, 2019. "Aiming High: Navigating the Next Stage of Malaysia's Development.

14 IMF Departmental Papers, 2023. Accelerating Innovation and Digitalization in Asia to Boost Productivity. January.

15 IMF Departmental Papers, 2023. Accelerating Innovation and Digitalization in Asia to Boost Productivity. January.

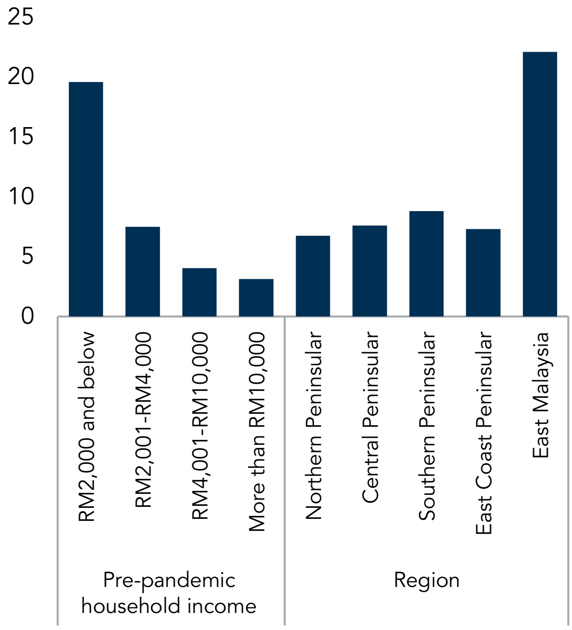
16 The HiFy Survey Round 3 was conducted from April 10, 2022, to May 15th, 2022. The survey involved 25–30-minute telephone interview of more than 1,000 panel respondents who continuously participated in the three survey rounds.

the recent surging in food prices,[17] with the trend of food security among the poor being reversed and worsened from May 2022. Despite various price controls and subsidies provided, one in five of poorest households (earning RM 2,000 and below) reported running out of food in the 30 days prior to the survey (Figure 25). This disproportionate impact of food inflation among poor households is somewhat to be expected, mainly because poor households spend a higher percentage of their income on food.[18] Moreover, the hardship brought about by the increase in prices of goods and services, in tandem with reduced incomes, was also cited as the main reason, by most of the poorest households, that they remained stuck in lower spending levels as of May 2022 relative to the pre-pandemic period.

FIGURE 25

Food insecurity remained higher among lower-income and East Malaysian households...

Households running out of food, percentage

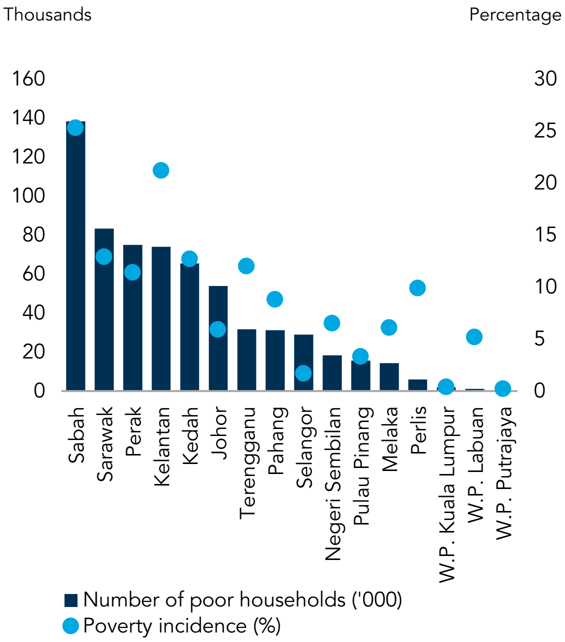


Source: World Bank High-Frequency Phone Survey Round 3 (2023)

FIGURE 26

...as more than one-third of income poor households live in Sabah and Sarawak of East Malaysia region.

Number of income poor households, Poverty incidence,



Source: World Bank staff calculations based on DOSM estimates (2021)

Uneven recovery is also evident across regions, with the risk of exacerbating inequalities across geographic areas. The HiFy findings showed that, after two years of the pandemic, households in the East Malaysia region[19] continued to experience slower progress in regaining employment than those in other regions. Consequently, as of May 2022, East Malaysia households continued to be more likely to experience food insecurity (Figure 26). They were also more concerned about their finances and more likely to be less able to cover their basic needs. Slower progress in the East Malaysia region is not surprising: in 2020, Sabah and Sarawak of East Malaysia were home to one-third of the total poor households in Malaysia (Figure 26). The absolute poverty rates in Sabah and Sarawak was also 3.0 and 1.5 times higher, respectively, than national poverty rate.[20] Moreover, East Malaysia also has the highest share of multi-dimensionally poor people (37.4 percent), who were categorized as deprived along four dimensions of well-being, namely, monetary poverty, education, health, and living conditions.[21] The pandemic thus emphasizes a need for more effective spatial strategies to protect poor and vulnerable groups, and avoid exacerbating already existing spatial inequalities (see Box 4: Food Security: Challenges and Policy Prescriptions for Malaysia).

17 The Consumer Price Index (CPI) for food and non-alcoholic beverages rose by 4.4 percent in May 2022 (YoY). *Sources*: Department of Statistics Malaysia. 2021. Consumer Price Index Malaysia.

18 Households in the B40 income distribution on average spend 37 percent of their expenditure on food, compared with 32 and 25 percent among those in the M20 and T20 income distribution. Department of Statistics Malaysia, 2020, Household Expenditure Survey Report 2019.

19 The East Malaysia region includes Sabah, Sarawak, and W.P. Labuan.

20 Department of Statistics Malaysia. 2021. Household Income Estimates and Incidence of Poverty Report 2020.

21 Estimated using the Household Income and Basic Amenities Survey 2016, following the modifications under "Alternative 1". At the national level, 15.3 percent of the population is estimated to be multidimensionally poor. For more details see the World Bank (2021) policy note, "Multidimensional Poverty in Malaysia: Improving Measurement and Policies in the 2020s".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BOX 4

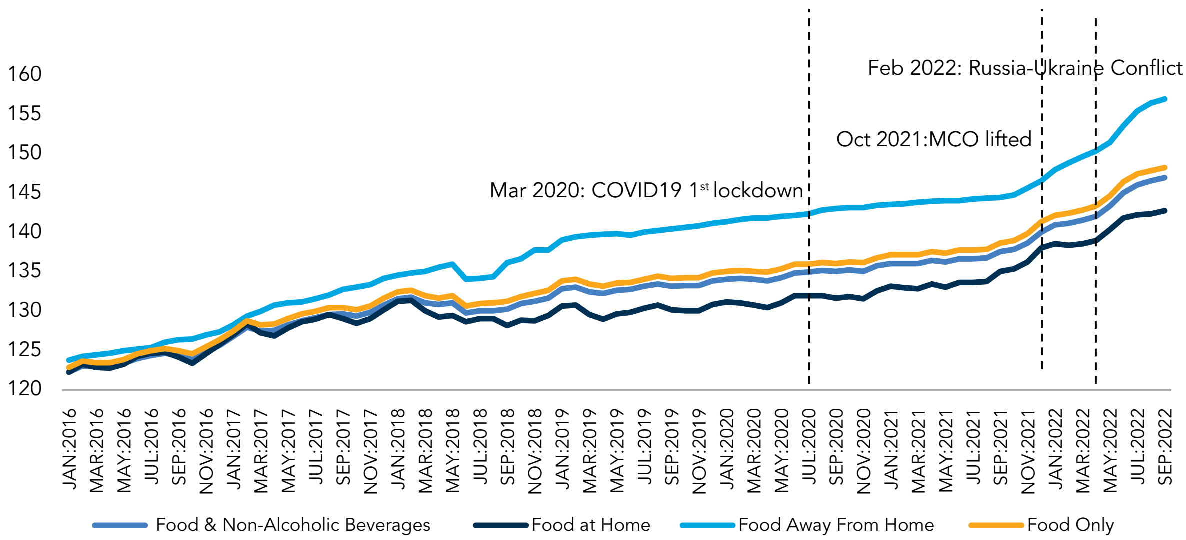
Food Security: Challenges and Policy Prescriptions for Malaysia

While Malaysia has been better placed in terms of exacerbated shocks of real food inflation and the ensuing food crisis, it is not fully insulated from its impact (Figure 27). Supply chain disruptions in the wake of the pandemic, the Ukraine war has caused significant tremors in the international food system due to the global dependency on wheat, animal/ vegetable fats or oils exports, and fertilizer exports. For Malaysia, while the direct effect was rather tepid due to the relatively smaller percentage of wheat consumption, the effect is felt most strongly, both directly through trade restrictions and indirectly through increased prices of fertilizers and due to the passthrough effects of higher energy prices. The inflation for food & non-alcoholic beverages from January to August 2022 increased by 5.1 percent as compared to the same period of the previous year. In August alone, the price of this category increased by 7.2 percent (YoY) compared to 2021. Food security has become a pertinent issue as the purchasing power and income of the vulnerable segment of society (B40 and below) declines.

FIGURE 27

Malaysia is not fully insulated from the impact of shocks to food inflation.

Consumer Price Index for Sub-Groups Food and Non-Alcoholic Beverages, Index (2010=100)



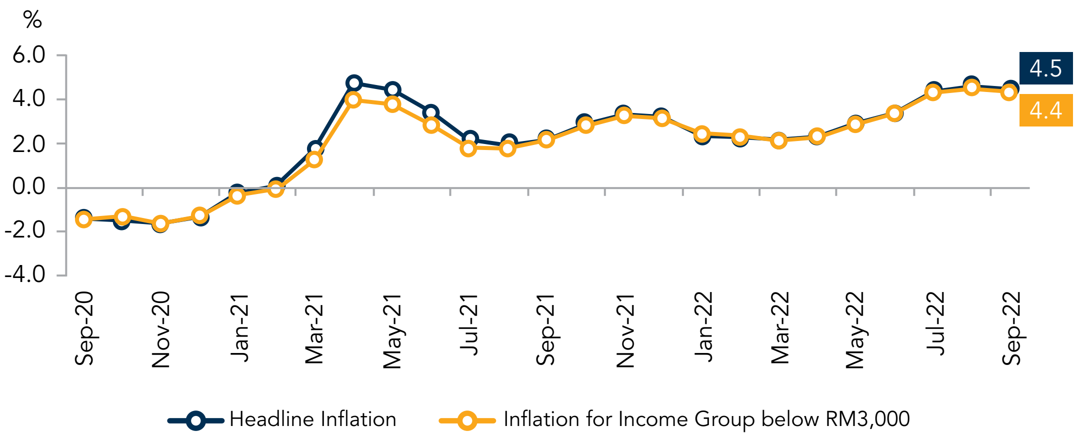
Source: DOSM

Due to the dimensions of food security being linked with one another, the impact of inflation on nutritional outcomes is deemed cross-cutting. The direct impact of food price inflation is more prevalent in the accessibility dimension. The soaring prices coupled with increased demand for food and insufficient local production to meet the demand caused food to be less accessible to poor and vulnerable groups (Figure 28 and 29).

FIGURE 28

Soaring prices coupled with increased demand for food and insufficient local production caused food to be less accessible to poor and vulnerable groups.

Inflation for Income Group Below RM3,000, September 2020–September 2022, percentage

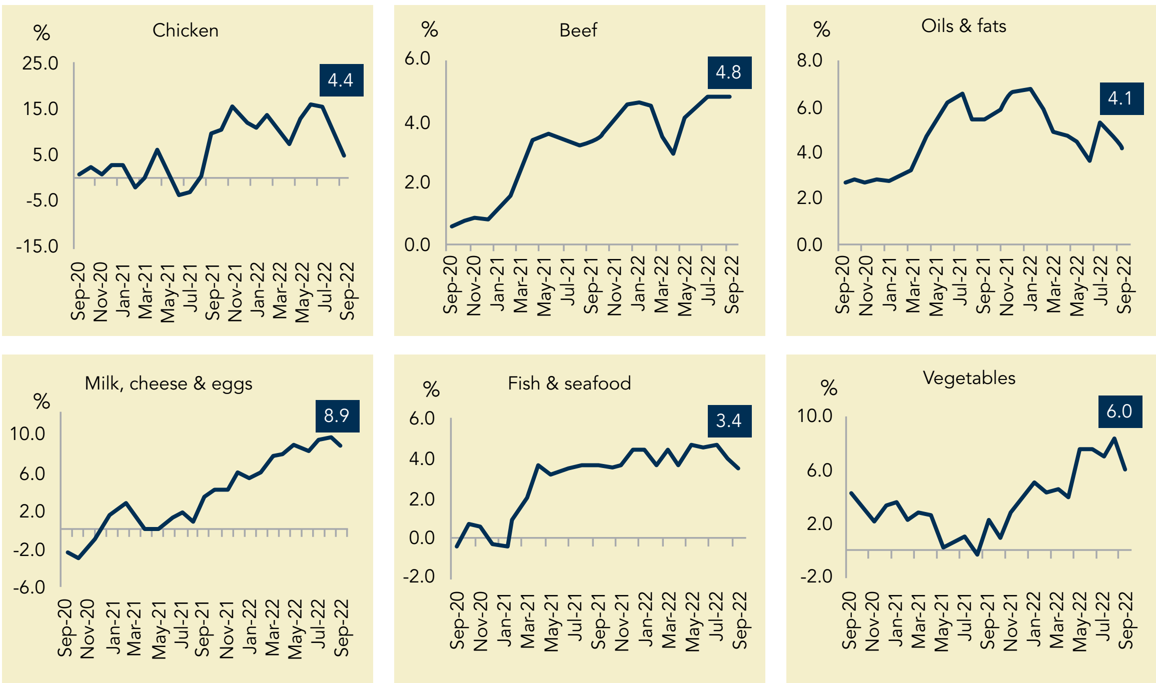


Source: DOSM

FIGURE 29

Soaring prices coupled with increased demand for food and insufficient local production caused food to be less accessible to poor and vulnerable groups.

Selected Food Inflation for Income Group Below RM3,000, September 2020–September 2022



Source: DOSM

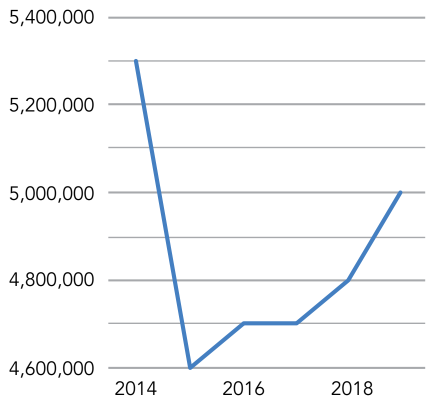
A spillover impact from higher food inflation is disruption in food production which may indirectly affect food security. For example, be it an increase in savings or a reduction in expenditure, households and private sectors may need to reallocate their resources to cope with future shocks. Often, inflation exacerbates existing challenges that affect producers and farm operators. For example, the increase in the national monthly minimum wage in May 2022 by 25 percent from RM1200 to RM1500 may put a strain on the producers. This may imply the reallocation of resources by the producers or farm operators from (the already low) R&D or other productivity-based expenditures to cover for the increase in labor cost. Producers also must reduce the number of workers employed to lower operating costs. The decline in labor productivity and increase in operational costs are occurring at a time when restrictions on hiring foreign workers are in place. Fewer workers could lead to a scale-down in production, thus lowering food supplies and subsequently affecting the availability dimension of food security. With lesser supply to meet demand, this cycle further contributes to price hikes in food. All these present major risks to the food security situation for the poor and vulnerable populations in the in the agriculture sector.

Worryingly the incidence of severe food insecurity has been increasing in Malaysia (Figure 30). In 2019 - 2021, the prevalence of moderate or severe food insecurity in Malaysia was 15.4 percent which is equivalent to 5 million people. While in absolute terms, 800,000 people were estimated to be undernourished in the same period. Overall, while food demand is moving away from rice as urban consumers grow richer in the country, insufficient diversification in domestic production has led to growing imports in important categories of food products, especially meats and edible offal, maize, and soybeans. This has adversely impacted the poor in Malaysia.

FIGURE 30

Worryingly the incidence of severe food insecurity has been increasing in Malaysia.

Number of people moderately or severely food insecure, million



Source: FAO

The policy responses to food security have remained short-term in nature, relying on a mix of protective trade measures and provision of input subsidies as well as social protection support. According to analysis based on global data, such protective trade measures acted only as a short-term panacea that amplified price fluctuations.[22] In the Malaysian, context, the current support in the form of direct input subsidies mainly supporting rice often entrenches food production patterns that do not support diversification to meet changing demand patterns. The ambitious goals for green economic growth, strengthening food security, and international competitiveness, and such a vibrant, forward-looking society requires equally ambitious goals related to its agro-food sector.

An urbanizing, high-income aspirant like Malaysia needs a food policy that is consistent and synergistic with the multiple sectoral policies and programs that impact the country's food system and its different stakeholders. This policy will balance attention between consumer preferences and food supply dimensions, as well as between primary production and food system challenges beyond the farm gate. In aspirational terms, it means moving toward an agri-food system that is: (i) resilient in the face of risks (reduce cost of imports by replacing quantitative import restrictions with transparent and predictable tariffs; streamlining import licensing and permit requirements for agriculture products; and allowing competitive imports of rice), (ii) inclusive in the opportunities it provides and the consumers it services, (iii) competitive in domestic and international markets (it is very import to repurpose fertilizer subsidies and market price support that distort farmer incentives and hurt consumers and instead to provide direct income support to farmers) and (iv) environmentally sustainable from farm to fork. And rather than focusing on rice production and assuring a diet with adequate calories, future policy should also balance attention across food nutrients—carbohydrates, micronutrients, and protein—and between the quality of food (and diets) and the quantities available.

22 Global data shows, measures to protect domestic markets and consumers introduced during the 2010–11 food price spike are estimated to have accounted for 40 percent and 25 percent of the increase in the world price of wheat, and maize, respectively (World Bank 2022).

Consumer price inflation in Malaysia has started to moderate after peaking in 3Q 2022

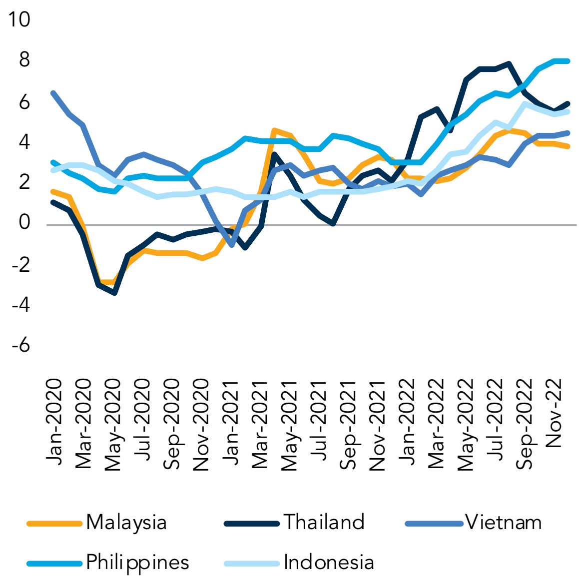
Despite some improvement in global supply chain conditions, global inflationary pressures remain elevated. Several factors - the war in Ukraine, higher commodity prices, a strong US Dollar- have contributed to inflationary pressures around the world. Consequently, many central banks have reduced the degree of monetary accommodation. For instance, the United States Federal Reserve has raised the federal funds rate by 225 basis points in total since March 2022 and is expected to tighten its monetary policy further this year.[23]

Consumer price inflation in Malaysia has started to moderate after peaking in 3Q 2022. In line with global inflationary pressures, consumer price inflation in Malaysia rose consecutively between April and August 2022, mainly driven by food and beverages, as well as housing, water, and electricity (Figure 31 and Figure 32). Since peaking in August 2022, inflation has eased due to housing, water, electricity, and gas, reflecting the decline in oil prices. Compared to August 2022, the contribution of housing, water, and electricity to CPI inflation more than halved (0.3 ppts; August 2022: 1 ppts)) . In the first half of 2022, when inflation rate was rising in regional peer countries and around the world, it remained broadly stable in Malaysia, likely due to subsidies and price controls[24] (see Box 5: Sudden Fuel Subsidies Removal Could Increase Inflation with Uneven Impacts Across Sectors). Estimated at 3.8 percent in December (November: 4.0 percent), CPI inflation in Malaysia lags that of regional peers (Figure 31). Core inflation was estimated at 4.1 percent in December 2022, (November 2022: 4.2 percent).

FIGURE 31

The higher inflation was seen during the 2Q and 3Q 2022...

CPI (y/y), percentage

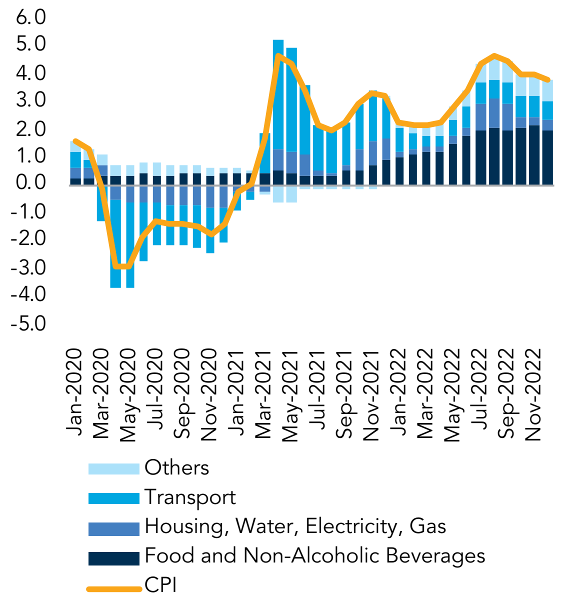


Source: DOSM and World Bank Staff Calculations

FIGURE 32

... mainly driven by food and beverages, as well as housing, water, and electricity.

Contribution to consumer price inflation, percentage



Source: DOSM and World Bank Staff Calculations

23 The raises were 25 bps, 50 bps, 75 bps and 75 bps at the March, May, June, and July meetings respectively.

24 For instance, in March 2022, the consumer price inflation in Malaysia was estimated at 2.2 percent, compared to 5.7 percent in Thailand, 4 percent in the Philippines, 8.5 percent in the US, 6.7 percent in Canada, and 7.4 percent in the Euro area.

BOX 5

Sudden Fuel Subsidies Removal Could Increase Inflation with Uneven Impacts Across Sectors

The rise in fuel subsidies in Malaysia is a risk to long term fiscal sustainability. Malaysia was one of only two countries in the EAP region which provided direct oil subsidies in 2020, and between these, Malaysia's direct oil subsidies as a share of GDP was the highest (Figure 33). These subsidies have increased in the years since the pandemic and are expected to cost around a significant RM 37.3b in 2022 (about 2.3 percent of GDP).[25] This rapid rise in fuel subsidies complicates long-term fiscal sustainability, so there is a pressing for subsidy reforms. Consideration needs to be given to removal of such subsidies. However, there are concerns that doing so could lead to inflation.

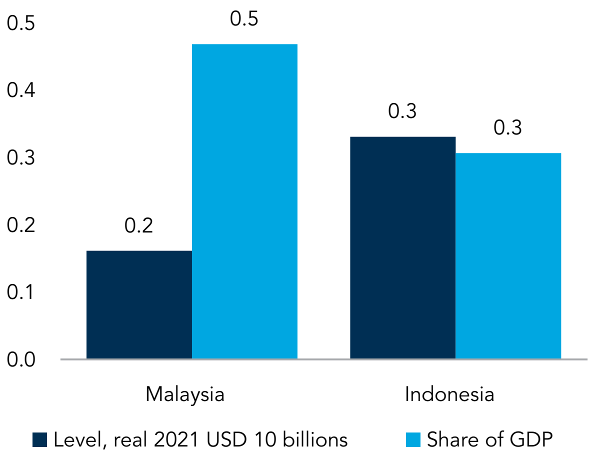
This box estimates the effect of fuel price subsidy removal on sectoral and aggregate prices by accounting for the full effect using Malaysia's input-output tables. For example, a rise in fuel prices increases prices in the transport sector (among others), which in turn raises prices for all other sectors including the fuel sector. The quantitative methodology employed here considers all such interactions through the supply effect.[26]

Estimations show that the removal of fuel subsidies is likely to have a significant impact on price levels in Malaysia. Completely removing fuel subsidies is likely to cause a 9 percent increase in consumer prices whereas the effect on producer prices and the GDP deflator is likely to be relatively lower at 8.2 and 6.78 percent, respectively (Figure 34). If only half of the subsidies were removed, then the inflationary impacts would be halved as well. It is important to note that the indirect effect through sectoral input-output linkages plays a key role in propagating the effect of the fuel price increase. This is evident from a much lower direct effect of fuel price increases on consumers and other prices. This direct effect only considers the share of fuel in the consumer basket, while maintaining all other prices constant.

FIGURE 33

Fuel subsidies in Malaysia in 2020, accounted for almost 0.5 percent of GDP.

Share of fuel subsidies, percent of GDP

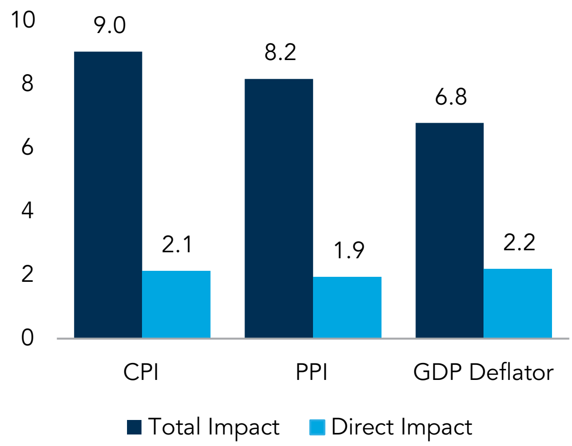


Source: World Bank Staff Calculations based on data from https://www.imf.org/en/Topics/climate-change/energy-subsidies

FIGURE 34

Complete removal of fuel subsidy would lead to an increase in price levels of about 9 percent.

Change in price levels, percent



Source: World Bank staff calculation based on Malaysia's input-output tables from 2020 (DOSM).

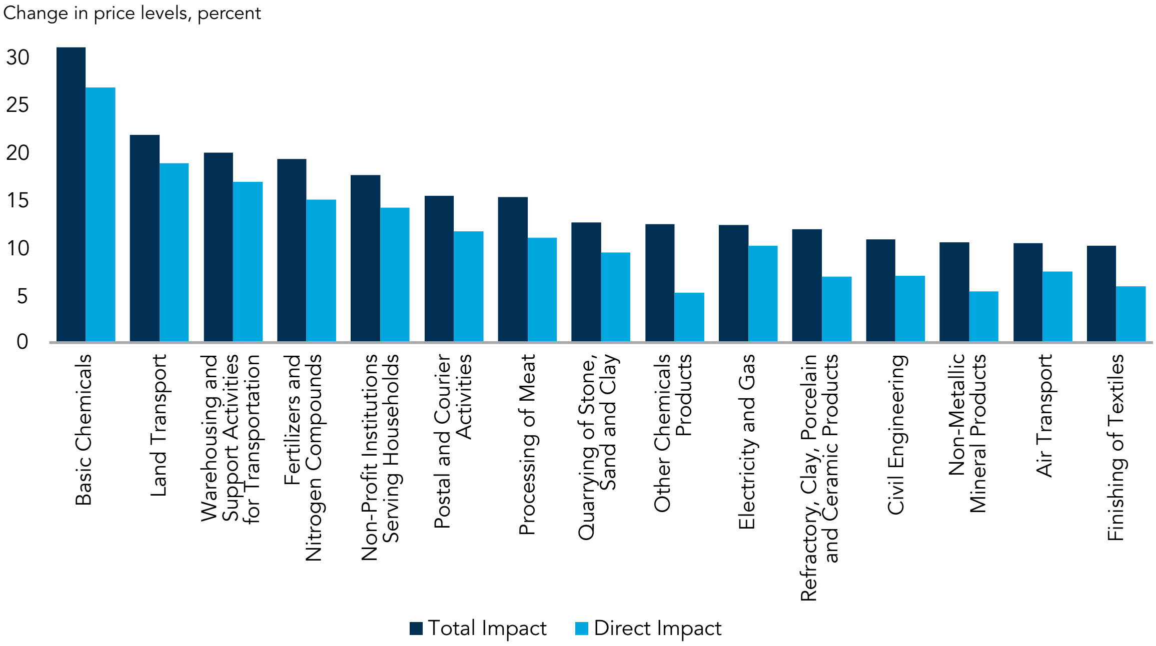
25 https://www.theedgemarkets.com/article/special-report-rm777-bil-subsidies-exceed-budgeted-development-expenditure-2022 Based on 2022 expected GDP.

26 Caveats of this approach include assuming fixed networks and complete passthrough of prices. It is not unreasonable to think that some sectors may be substituted away from because of price increases, or some sectors may not pass on the price to their customers (by adjusting their markups). These points require separate consideration and are assumed to be fixed here.

The price impact of the subsidy removal is not uniform across sectors. Sectors with a higher share of fuel input, such as chemical and transport, are expected to experience a large price increase upwards of 20 percent (Figure 35) following the removal of fuel subsidies. On the other hand, service sectors, such as telecommunications and insurance which rely less on fuel as input, are likely to be only marginally affected by fuel price increases (Figure 36).

FIGURE 35

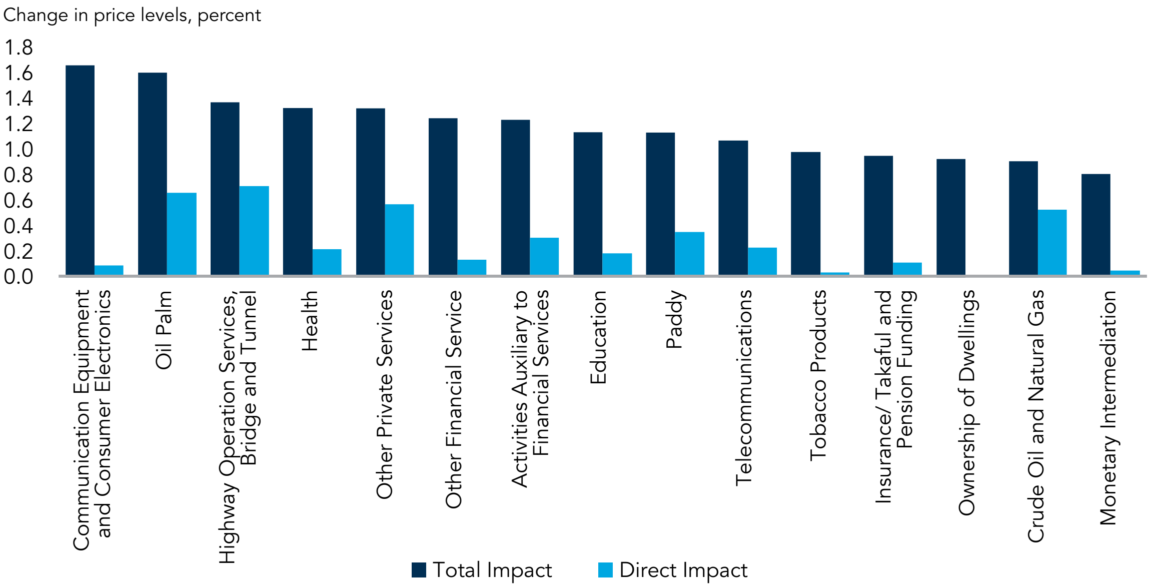
Chemicals and transport sectors would see the largest impact of fuel subsidy removal.



Source: World Bank staff calculation based on Malaysia's input-output tables from 2020 (DOSM)

FIGURE 36

Sectors with smallest impact of fuel subsidy removal include communications and health.

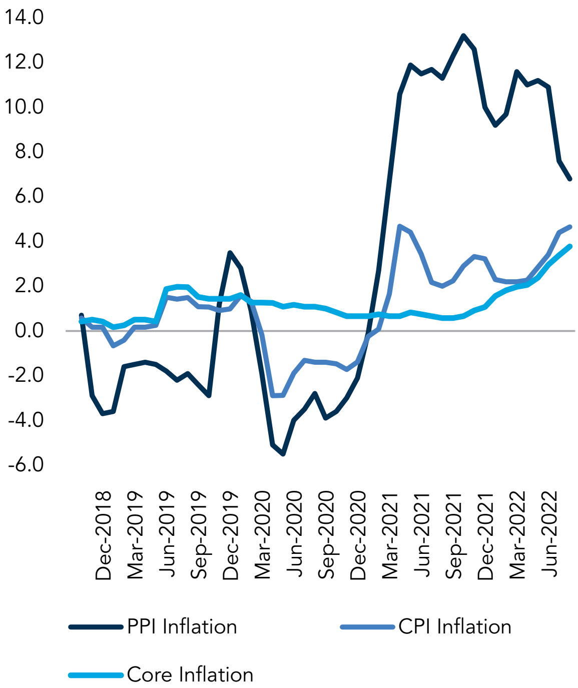


Source: World Bank staff calculation based on Malaysia's input-output tables from 2020 (DOSM)

While consumer price inflation has risen, producer price inflation has fallen in tandem, driven by broad-based decline in production index across sectors. Producer price inflation was estimated at 4.0 percent in October 2022, (September: 4.9 percent) (Figure 37). This decline in producer price inflation has been underpinned by a consecutive decline in the producer price index in agriculture, forestry, and fishing, and a lower growth in the price index cross all remaining sectors (Figure 38), likely due to easing of labor shortage and improvement in crop yield.

FIGURE 37
Producer price inflation has fallen in recent months…

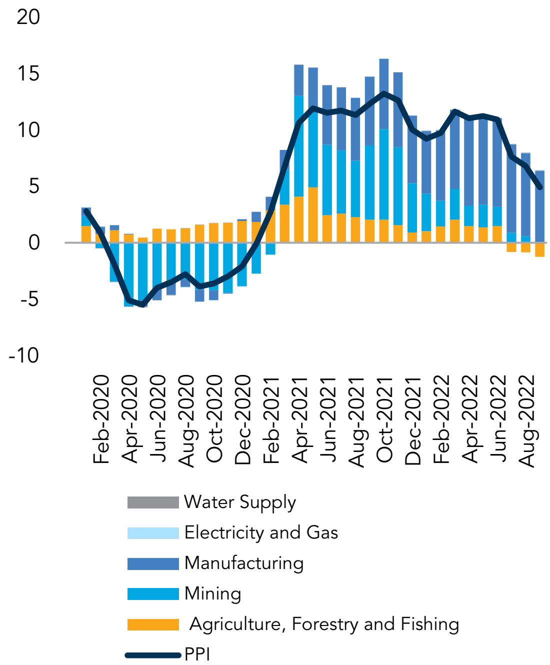
CPI, PPI (y/y), percentage



Source: DOSM and World Bank Staff Calculations

FIGURE 38
…underpinned by a consecutive decline producer price in agriculture, forestry, and fishing.

Contribution to producer price inflation, percentage



Source: DOSM and World Bank Staff Calculations

The increase of the overnight policy rate (OPR) in November 2022 was a pre-emptive move by the central bank (BNM) to manage the risk of excessive demand on price pressures, balancing the risks to inflation and growth. This was the fourth consecutive increase in the OPR, and it now stands at 2.75 percent. The monetary policy committee (MPC) cited improvement in the domestic economy and labor market for the decision to reduce monetary accommodation. Despite the recent uptake in inflation, the committee still expects annual inflation rate in 2022 to be between 2.2 and 3.2 percent. The current upcycle in the economy – quick economic rebound and rising inflationary pressures provides a further footing for the recent monetary policy tightening by the monetary committee.

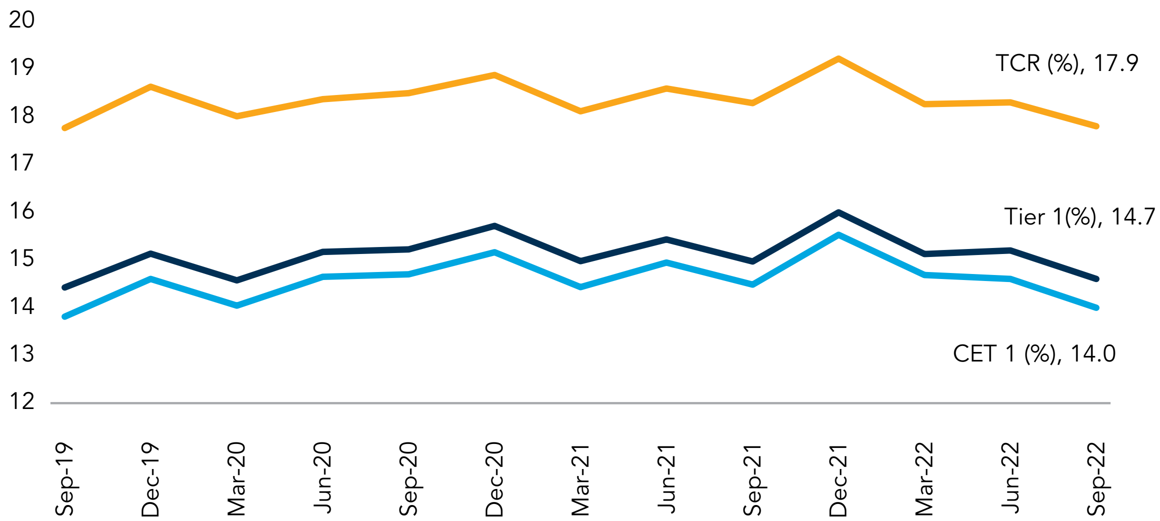
The banking sector remains well-capitalized and has ample liquidity

The Malaysian banking sector has maintained solid capital and liquidity position. The total capital ratio and tier 1 capital ratio remained well over the regulatory minimum capital level[27] at 17.9 percent and 14.7 percent as of end September 2022, lower compared to Q4 2021 (19.2 percent and 16.0 percent respectively) (Figure 39). Liquidity coverage ratio and net stable funding ratio remained high at 152.0 percent as of end September 2022 and 118.5 percent as of end June 2022 respectively, above the statutory requirement of 100 percent, supported by sustained growth in deposits. Banks had higher profitability compared to the previous year, with return on equity and return on assets increased to 12.4 percent and 1.4 percent respectively at end September 2022 (Q4 2021: 9.5 percent and 1.1 percent respectively).

FIGURE 39

Capital ratios remained well over the regulatory minimum capital.

Total capital ratio, Tier 1 capital ratio, percentage



Source: BNM

Whilst total volume of impaired or non-performing loans (NPLs) are on the rise, gross NPL ratio remain relatively low compared to levels experienced in the previous crises. Total volume of NPLs has increased by 12.0 percent per year as end September 2022, with the ratio of gross NPLs increasing to 1.82 percent at end September 2022 (Figure 40). Despite the increase, Malaysia's gross NPL ratio remains among the lowest among the ASEAN-5 countries, where ratios have ranged between 1.5 percent and 3.9 percent.

Banks have set aside provisions for NPLs and have substantial capacity to absorb the expected increases in NPLs. Total provisions stood at RM35.4 billion as of September 2022, unchanged compared to the same period last year, though the ratio of provisions to impaired loans declined to 97.3 percent, down from 109.3 percent at the end of 2021.[28] BNM stress testing results published in October 2022 indicated that financial institutions can withstand increases in impairment under simulated severe macroeconomic and financial shocks.[29]

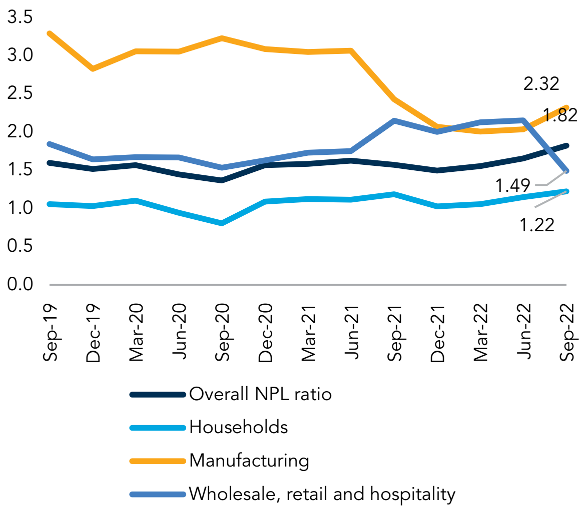
27 Minimum capital adequacy ratios: CET1 Capital Ratio – 4.5%, Tier 1 Capital Ratio – 6% and Total Capital Ratio – 8%.

28 Total Provisions consist of 12 Months Expected Credit Losses (ECL), Lifetime ECL Not Credit Impaired and Lifetime ECL Credit Impaired.

29 The simulated conditions include higher impaired loans ratio arising from additional borrowing costs and basic expenditure shocks, and additional shocks related to a depreciation of the ringgit and increased US Federal Funds rates.

FIGURE 40
Gross NPL ratio remain relatively low compared to levels experienced in the previous crises.

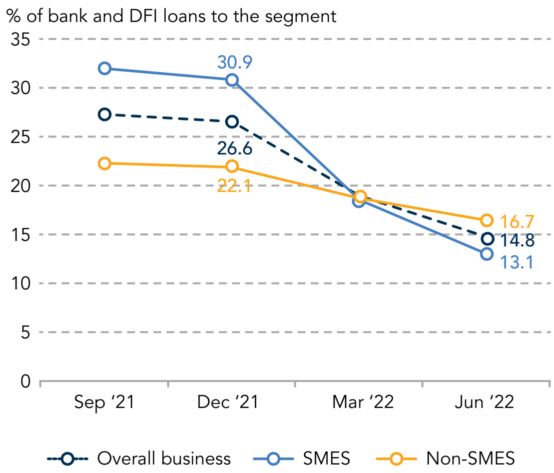
Gross impaired loans ratio, percentage



Source: BNM

FIGURE 41
Share of loans under repayment assistance has declined.

Share of business loans under repayment, percentage



Source: BNM

Since the expiry of standardized repayment assistance, the share of business loans under repayment assistance has declined to just 14.8 percent of total banking system loans (including development financial institutions) at end June 2022 (end-2021: 26.6 percent) (Figure 41).[30] As of June 2022, 13.1 percent of total SME loans (or 2.3 percent of total loans outstanding) remained under repayment assistance, compared to 30.9 percent at end 2021. About 94 percent of total business loan accounts approved for rescheduling and restructuring (R&R) were made up of SMEs. Household loans under repayment assistance have also declined to 2.4 percent of total loans outstanding at end June 2022 compared to 18.8 percent as of December 2021. Moving forward, financial institutions have been given the flexibility to address repayment issues on a case-by-case basis. Struggling borrowers can approach the Credit Counselling and Debt Management Agency (*Agensi Kaunseling dan Pengurusan Kredit*, AKPK) to seek advice on financial education, advisory and debt management services. Effective support on debt management and resolution can help alleviate high levels of debt distress to safeguard the safety and soundness of the financial sector. Bankruptcy action continues to be the last resort for banks, after exhausting all other debt rehabilitation and recovery efforts.

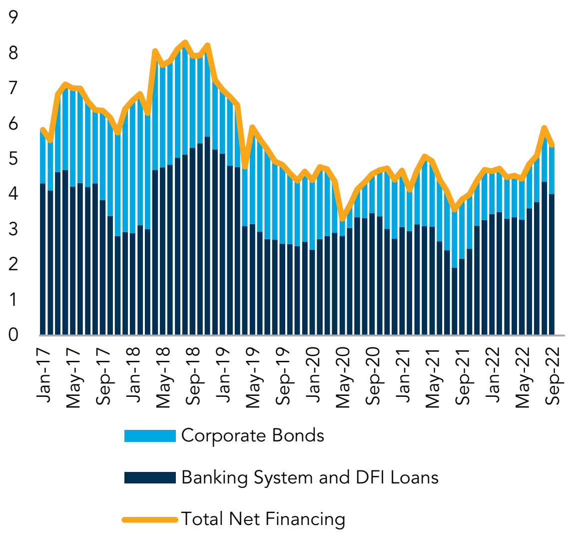
Signs of recovery continue with credit to the private sector growing in resulting in an increase in net financing as of end September 2022 (Figure 42). Net financing, which comprises of outstanding loans and corporate bonds, expanded at a rate of 5.4 percent in September 2022 (Q4 2021: 4.7 percent). Outstanding household loan grew by 6.2 percent annually in September 2022 (Q4 2021: 4.2 percent) (Figure 43). The growth in household loans were mainly driven by credit card loans, purchase of residential properties and passenger cars, which made up 76.8 percent of all household loans at end September 2022. Meanwhile, growth in outstanding business loans was higher at 5.0 percent in September 2022 (Q4 2021: 4.8 percent), amid a higher growth in working capital loans. From a sectoral perspective, the utilities and transport sectors recorded the highest annual growth in outstanding loans, 47.0 percent, and 27.0 percent respectively, over the same period.

30 BNM Financial Stability Review – First Half 2022.

FIGURE 42

Net financing expanded in line with the economic recovery.

Contribution to net financing growth, y/y, percentage

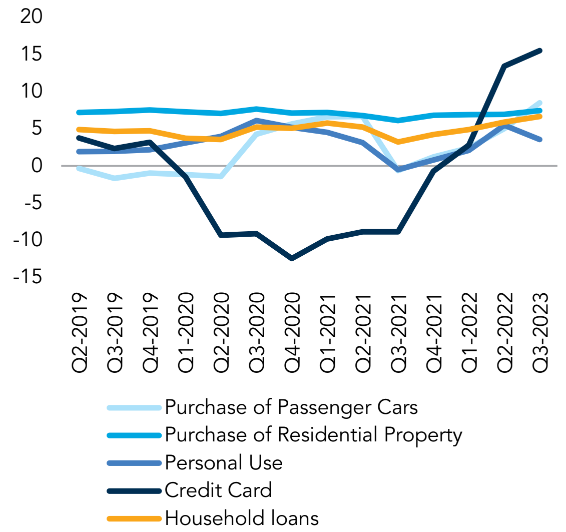


Source: World Bank staff calculations based on BNM data

FIGURE 43

Growth in household loans was driven by credit cards, and purchase of properties and vehicles.

Outstanding loans growth, y/y, percentage



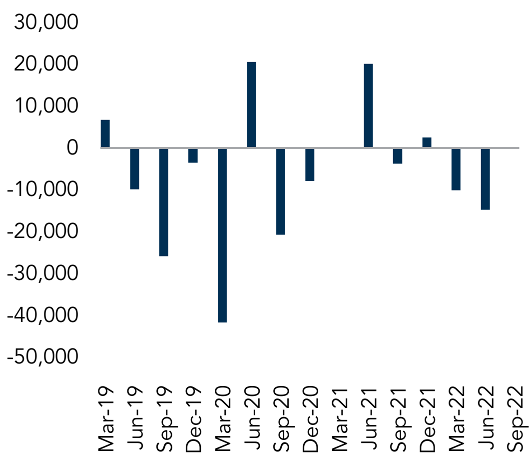
Source: World Bank staff calculations based on BNM data

In the domestic financial markets, monetary policy tightening by the Fed in the US has led to portfolio outflows and rising volatility (Figure 44). In the domestic bond market, portfolio outflows have led to higher government bond yields across all maturities. Between June to September 2022, the 3-, 5-, and 10-year Malaysian government securities (MGS) yields rose 29, 14 and 22 basis points respectively (Figure 45). The increase in the yield as also partly due to the increase in the OPR by BNM. Nevertheless, deep liquidity from local institutional investors helped to cushion the increase in bond yields. Similarly, in the equity market, portfolio outflows have led to heightened volatility in the domestic equity market.

FIGURE 44

Net financing expanded in line with the economic recovery.

Net portfolio flows, RM million

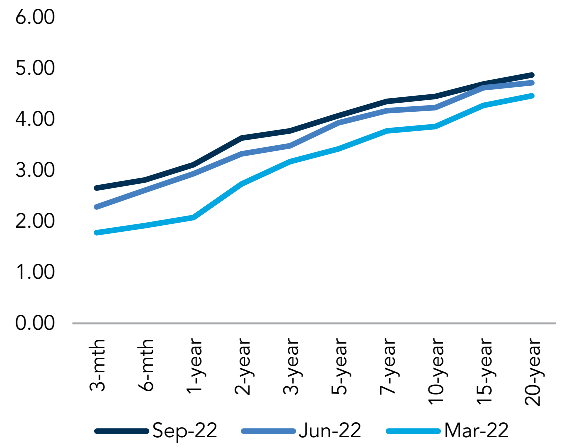


Source: DOSM and BNM

FIGURE 45

Portfolio outflows have led to higher government bond yields across all maturities.

MGS bond yields, percentage



Source: World Bank staff calculations based on BNM data

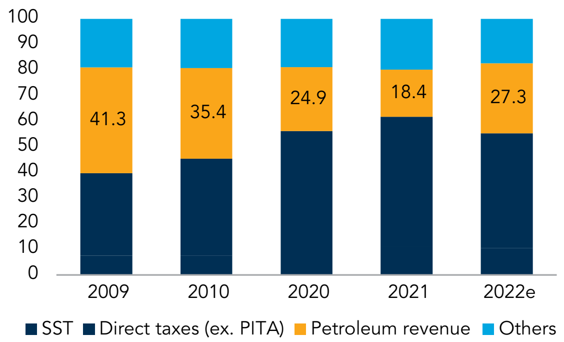
Declining trend in government revenue is expected to continue in 2023 after temporary increase in 2022

Higher petroleum-related revenue contributed to slightly higher revenue collection in 2022. Federal government revenue is projected to increase from 15.1 percent of GDP in 2021 to 16.7 percent. The increase was mainly driven by higher petroleum-related revenue. Petroleum income tax (PITA) rose to 1.1 percent of GDP (2021: 0.7 percent) in line with higher oil prices. In addition, higher dividend from the Petronas contributed to higher investment income amounting to 3.7 percent of GDP (2021: 2.3 percent). The increase in petroleum-related revenue, particularly on dividend from Petronas underscores the continued reliance on petroleum-related revenue which accounted to 27.3 percent of total government revenue in 2022 (2021: 18.4 percent) (Figure 46). Proceeds from other main sources of revenue including corporate income tax, personal income tax (PIT) and sales and services tax (SST) remain unchanged from 2021 at 5.2 percent, 1.8 percent, and 1.7 percent of GDP respectively.

FIGURE 46

Higher share of petroleum-related revenue on higher global oil prices.

Share of revenue items, Percentage

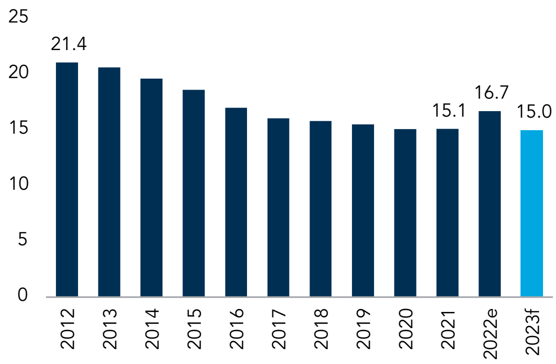


Source: MOF and Haver

FIGURE 47

Revenue collection is expected to decline in 2023.

Federal government revenue, Percentage of GDP



Source: MOF and Haver

Revenue collection is expected to resume its downward trend in 2023, declining to 15 percent of GDP (Figure 47). With crude oil prices expected to moderate in 2023, PITA is projected to decline to 0.9 percent of GDP, while investment income would decrease to 2.3 percent of GDP. In addition, Malaysia continues to under collect in personal and consumption taxes, trailing many comparative peers. Revenue from personal income tax (PIT) is expected to be at 1.9 percent of GDP (2022: 1.8 percent) while revenue from the sales and services tax (SST) is projected to be at 1.8 percent of GDP (2022: 1.7 percent). In contrast, the average for comparative peers stood at 6.4 percent and 10.4 percent respectively.[31]

The announcement of several measures in the draft Budget 2023 could contribute to lower revenue collection going forward. A 2 percent personal income tax rate reduction, from 13 percent to 11 percent is announced for middle-income households with taxable income of between RM50,000-70,000. In addition, households with taxable income of between RM70,000-100,000 would see their personal income tax rate decline from 21 percent to 19 percent. While a higher tax rate of 25 percent (previously 24.5 percent) will be applied to households with a taxable income of RM250,000-400,000, overall, this is expected to have limited impact on improving revenue collection in the future.

31 Average for 2022. Comparative peers include Organization for Economic Co-operation and Development (OECD) countries; countries that achieved high-income status in the last 30 years; and regional peers consisting of other Association of Southeast Asian Nations (ASEAN) countries.

Government expenditure rose in 2022 on higher subsidies spending

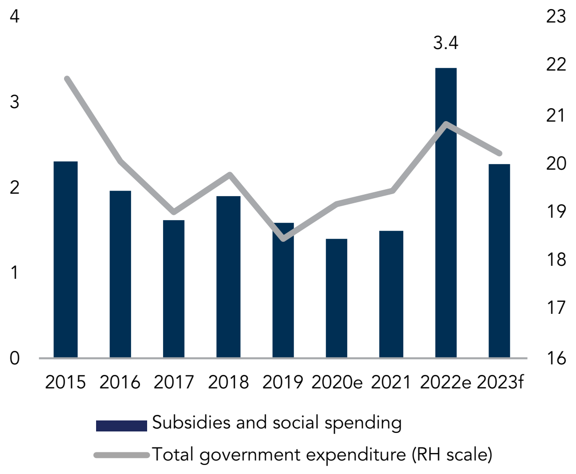
Total government expenditure increased in 2022 on higher subsidies spending following higher global oil prices. Overall, government spending increased to 20.8 percent of GDP in 2022 (2021: 19.2 percent). The outlays for subsidies and social assistance jumped to 3.4 percent of GDP in 2022 (2021: 1.5 percent) as the government capped the retail prices for RON95 and diesel during the year (Figure 48). In addition, the government subsidies were allocated for bottled cooking oil from August 2021 until June 2022 as well as for poultry products since early 2022 as part of the government's efforts to contain rising cost of living pressures. For 2023, the government expects subsidies spending to moderate slightly to 2.3 percent of GDP as global oil prices are expected to subside.

Blanket, untargeted subsidies took up the larger share of subsidies spending in 2022. It is estimated by the government that the total expenditure on blanket fuel subsidies amounted to about 2.4 percent of GDP, or 48 percent of total subsidy spending (Figure 49). In comparison, the spending allocation for Ministry of Health, and Ministry of Education in 2022 stood at 1.9 percent and 3.1 percent respectively.[32] Blanket subsidies are regressive in nature, with the benefits enjoyed disproportionately by higher-income households. Government estimates suggest that the richest 20 percent of households in Malaysia received about 53 percent of the fuel subsidy.

FIGURE 48

Higher subsidies and social spending contributed to higher government spending in 2022.

Government spending, percentage of GDP

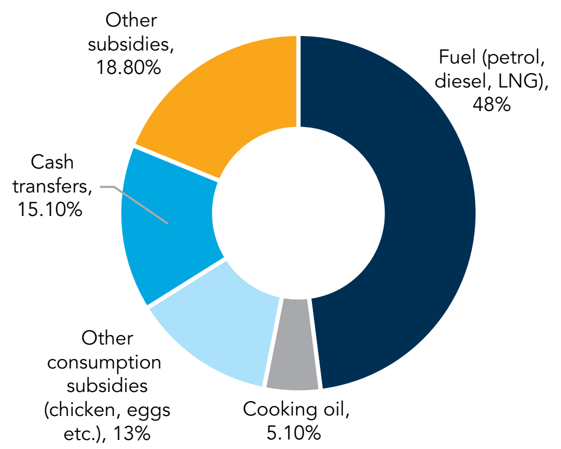


Source: MOF

FIGURE 49

Fuel subsidies took up the largest share of the subsidy bill in 2022.

Breakdown of subsidy spending in 2022, percentage of total subsidies



Source: MOF

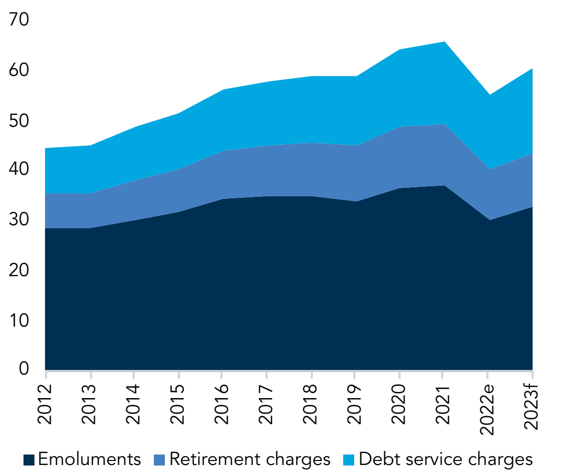
32 Estimates of federal government spending by ministries (https://budget.mof.gov.my/ms/bajet2023/perbelanjaan/)

Rigid expenditures remain high and expected to increase in 2023

Rigid expenditures remain high and is expected to increase in 2023. Rigid expenditures – namely obligations related to salaries, pensions, and interest payments stood at around 56 percent of total operating expenditures in 2022 (2021: 66 percent) (Figure 50). Furthermore, interest payments remained above administrative limit of 15 percent of federal government revenue.[33] The interest payments over revenue ratio stood at 15 percent in 2022 and is forecasted to increase to 17 percent in 2023. Moving forward, the combined spending on these structural expenditures is expected to increase to 61 percent of total operating expenditures in 2023. The increased spending on these items, together with the decline in revenue, remains a constrain to the government's fiscal space and posing a challenge to long-term fiscal sustainability.

FIGURE 50
Rigid spending remains high in 2022 and expected to increase in 2023.

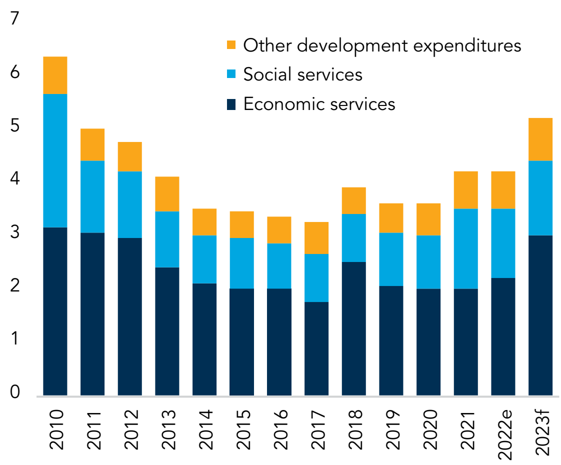
Structural expenditures, percentage of total government spending



Source: MOF

FIGURE 51
Allocation for development spending is expected to slightly increase in 2023.

Development expenditure (DE), percentage of GDP



Source: MOF

Allocation for development spending projected to increase slightly in 2023 (Figure 51). Development spending in 2022 stood at 4.2 percent of GDP (2021: 4.2 percent). Most of the development spending in 2022 went into the economic sector (52 percent of total development spending), mainly for upgrading public transportation infrastructure including for the LRT3 project and upgrading of the Kota Bharu airport. Development expenditures are expected to increase in 2023 to 5.2 percent of GDP driven by several 12MP-related projects which is expected to gain momentum. These projects include the Trans Borneo Highway and the Sarawak Sabah Link Road Phase 2.

Malaysia's development spending is comparable to its comparative peers, but execution challenges exist. Compared to the OECD average, government investment in Malaysia stood at 4.1 percent of GDP, above the OECD average of 3.1 percent (Figure 52).[34] However, Malaysia's development budget tends to be underspent, partly due to actual OE exceeding their original appropriated budgets. The execution of

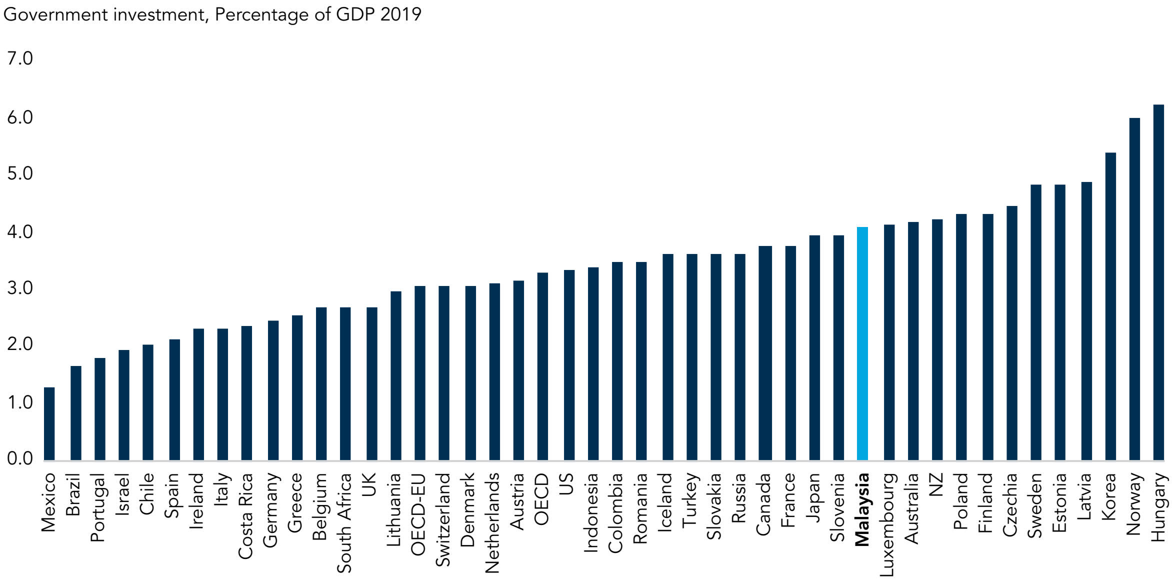
33 The administrative limit is part of the government's prudential measure. As stipulated under the Federal Constitution, interest payment must be prioritized before all other operating expenditure items.

34 For Malaysia, this is measured by government's development expenditure. For OECD countries, general government investment includes gross capital formation and acquisitions, less disposals of non-produced nonfinancial assets. Gross fixed capital formation is the main component of investment. For government, it mainly consists of transport infrastructure but also includes infrastructure such as office buildings, housing, schools, and hospitals. (https://www.oecd-ilibrary.org/sites/e2ee1eb1-en/index.html?itemId=/content/component/e2ee1eb1-en)

allocated budgets is undermined by gaps in budget planning, as well as ad-hoc measures or policies being introduced during the fiscal year. The growing trend in OE, particularly in structural expenditure, crowds out funding of development projects, making it more difficult to achieve development goals. In addition, the already high debt level (61 percent of GDP as at end-June 2022) limits the government's ability to increase its borrowings to fund development spending.

FIGURE 52

Government investment is comparable to comparative peers.



Source: OECD National Accounts Statistics (database), MOF

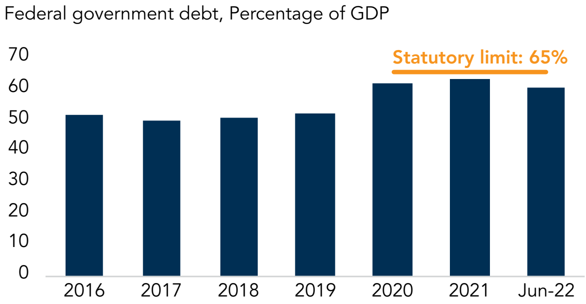
Government debt remains close to its statutory limit

Government debt remains close to its statutory limit (Figure 53). As part of the government's response to the pandemic, the parliament approved the Temporary Measures for Government Financing Act 2020 (Coronavirus Disease 2019 (COVID-19)) Act 2020 [Act 830], which raised the statutory debt limit to 65 percent of GDP until end-2022. As at end-June 2022, the Federal Government debt stood at 61 percent of GDP (end-2021: 63.4 percent). There was a noticeable increase in federal government debt during the pandemic and the government expects the statutory debt-to-GDP ratio to increase to 63 percent by end-2023. The government also stated that it may maintain the 65 percent debt limit beyond the current expiry of end-2022. While the higher debt limit has accommodated additional borrowings space to finance the fiscal stimulus during the pandemic, it has contributed to the marked increase in interest payment.

On government guarantees (GGs), total outstanding GGs moderated to 17.9 percent of GDP, (end-2021: 20.1 percent) (Figure 54). The slight reduction as compared to end-2021 was attributed to the completion of financing term for several GG projects. Out of the total outstanding GGs, 65 percent (end-2021: 64 percent) are committed guarantees whereby the government provides financial assistance in a form of temporary cash flow support, working capital assistance, interest repayment or operational subsidies to sustain ongoing projects.

FIGURE 53

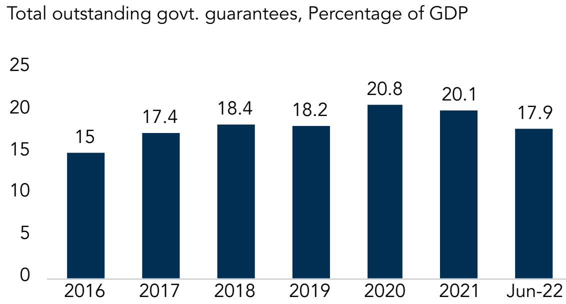
Government debt remains close to its statutory limit.



Source: MOF

FIGURE 54

Total outstanding government guarantee moderated in 2022.



Source: MOF

Analysis on Malaysia's revenue, spending and debt trends suggest that fiscal policy in Malaysia has been countercyclical relative to regional countries. Using annual data from 1990 to 2022 for Malaysia the empirical findings suggest that: i) spending policy in Malaysia is slightly countercyclical or acyclical; ii) tax policy is acyclical; and iii) debt policy is highly countercyclical. This signals that there is an increase in government spending during periods of slowdown to support the economy and should be viewed positively. Overall, these results are consistent with the cyclical behavior of fiscal policy in most advanced economies (see Box 6: Cyclicality of Malaysia's Fiscal Policy).

BOX 6

Cyclicality of Malaysia's Fiscal Policy - Closer to Advanced Economies Rather than Emerging Economies

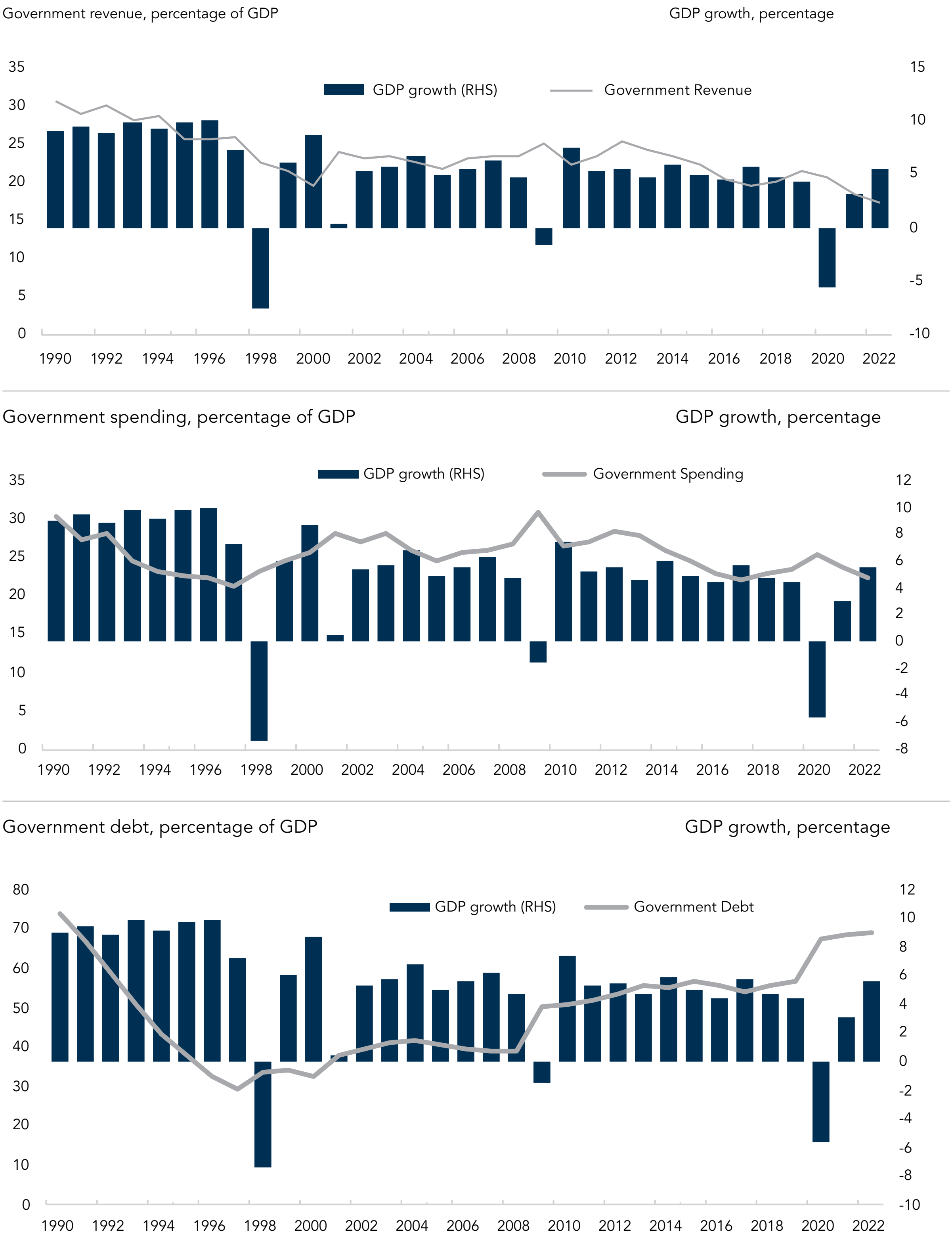
Fiscal policy in countries with better institutions and more integrated with capital markets tends to be less procyclical. It is well known that government spending has typically been procyclical in emerging markets and developing economies (EMDEs) but acyclical or countercyclical in advanced economies (Frankel, Vegh, and Vuletin, 2013). Moreover, studies have shown that tax policy is acyclical in advanced economies but mostly procyclical in EMDEs. Overall, the cyclical behavior of fiscal policy is an indicator of government's ability to mitigate negative shocks such as COVID-19. While countercyclical fiscal policy is related to governments that conduct an aggressive fiscal policy response during bad times, a procyclical fiscal policy refers to governments that expand fiscal policy during good times rather than bad times.

Fiscal policy in Malaysia mimics the behavior of fiscal policy in most advanced economies. Using annual data from 1990 to 2022 for Malaysia, we estimate the correlation between the cyclical component of GDP and the cyclical component of different fiscal variables such as government spending, government revenue-to-GDP ratio, and government debt. The empirical findings suggest that: i) spending policy in Malaysia is slightly countercyclical or acyclical; ii) tax policy is acyclical; and iii) debt policy is highly countercyclical. Overall, these results are consistent with the cyclical behavior of fiscal policy in most advanced economies, suggesting that fiscal policy in Malaysia follows similar patterns as in advanced economies.

Historically, fiscal policy in Malaysia has consistently been countercyclical (Figure 55). The cyclical behavior of fiscal policy in Malaysia can be characterized in the following periods: i) Pre-AFC; ii) Pre-GFC; iii) Post-GFC; and iv) COVID-19 times. The period preceding the Asian Financial Crisis, was characterized by outstanding economic growth that enabled the government to reduce government debt by 44.5 percentage points. During this period of economic expansion and debt reduction, government spending and revenues also followed a downward trend, which explains the high countercyclicality observed in this period. After the Asian Financial Crisis, economic growth dropped, government spending increased in the early 2000s, tax revenue was relatively stable, and public debt started following an upward trend. In the period following the Global Financial Crisis, government spending and revenue have been less countercyclical. However, public debt has been increasing even though growth rates have been lower relative to historical rates. Finally, during the COVID-19 induced recession, as well as in the other crisis periods, the government responded with larger government spending that was financed through debt accumulation, which explained the high countercyclicality observed in the last years.

FIGURE 55

Fiscal policy in Malaysia has consistently been countercyclical.



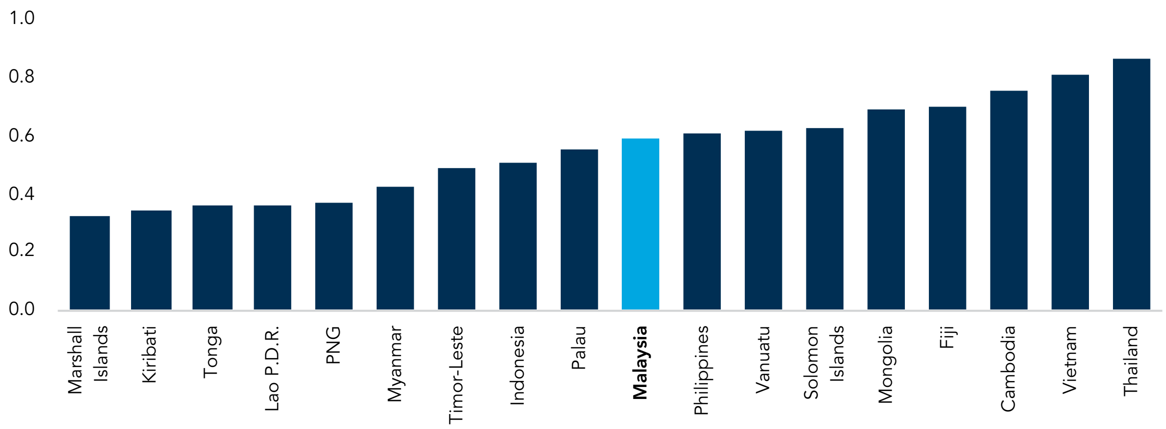
Source: World Bank Staff Calculations

Apart from Thailand and Indonesia, fiscal policy in Malaysia is also more countercyclical than any other developing EAP country (Figure 56). While government spending in Malaysia is more countercyclical than any other developing EAP country, except for Thailand, and public debt is more countercyclical than any other developing EAP country, except for Thailand and Indonesia, tax policy is not as countercyclical/ acyclical relative to the rest of the region. This fact could be driven by the petroleum income tax in Malaysia, which is a main component of tax revenues in the country.

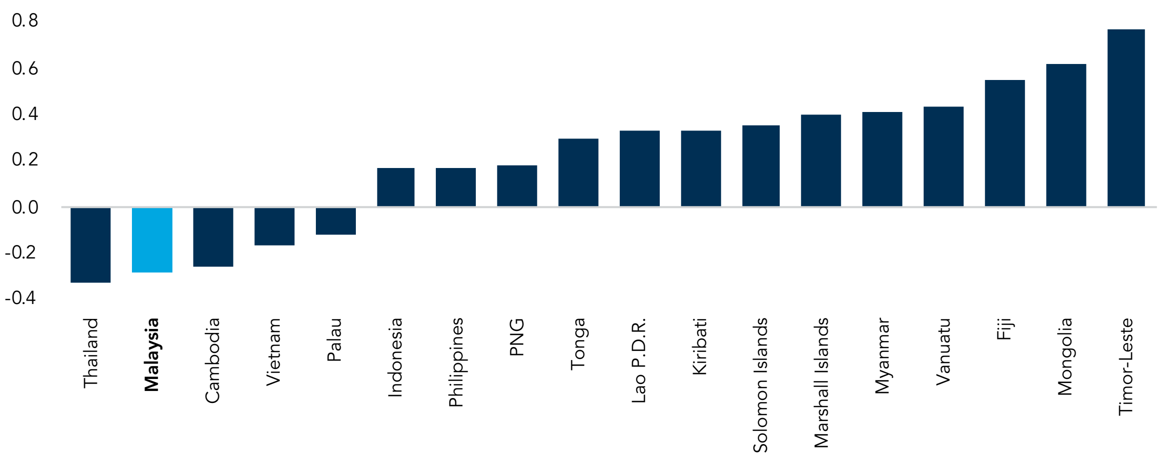
FIGURE 56

Compared to regional peers, Malaysia's fiscal policy is among the most countercyclical.

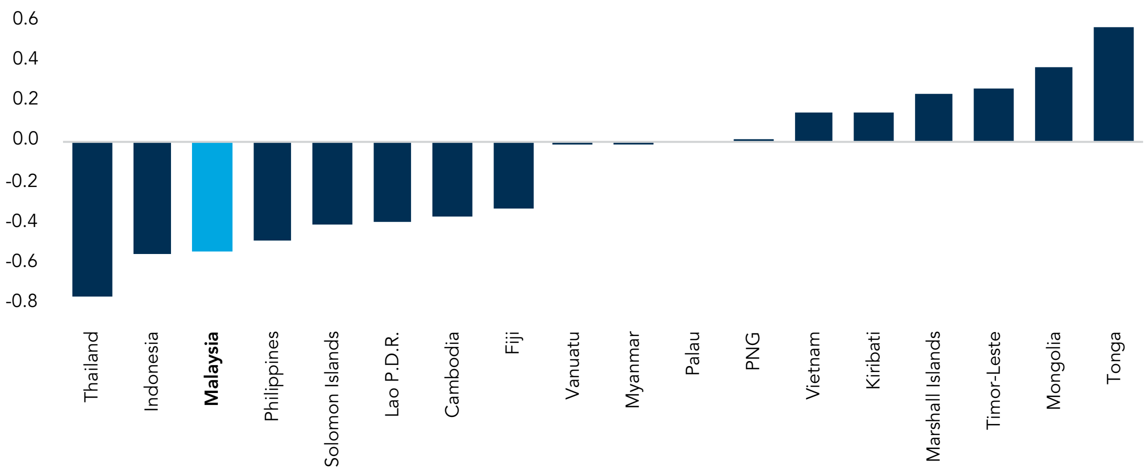
Correlation (GDP and government revenue)



Correlation (GDP and government spending)



Correlation (GDP and government debt)



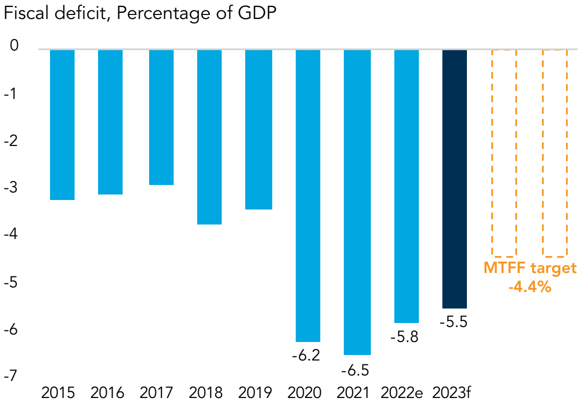
Source: World Bank Staff Calculations

Further narrowing of the government's fiscal space

The government's fiscal deficit projection in 2022 was revised from 6.0 percent of GDP to 5.8 percent. This is partly driven by higher-than-expected growth estimates for 2022 and higher petroleum-related revenue. Nevertheless, the higher revenue collection was partially offset by higher spending towards providing fiscal support, particularly additional subsidies amid the rising inflation and cost of living. For 2023, the government's target for fiscal deficit is 5.5 percent of GDP (Figure 57). The government has reiterated its commitment towards consolidating the fiscal position for a more sustainable public finance in the medium term.

FIGURE 57

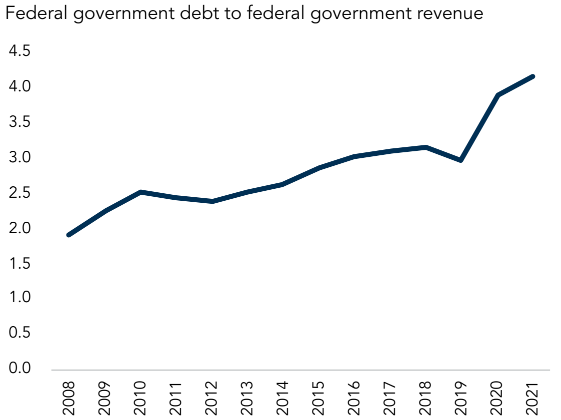
Government's fiscal deficit target for 2023 is at 5.5 percent of GDP.



Source: MOF

FIGURE 58

Fiscal space is expected to remain narrow.



Source: World Bank staff calculations based on Aizenman and Jinjarak (2010)

With government revenue projected to remain low and structural expenditures to remain high, this has led to further narrowing of Malaysia's fiscal space (Figure 58). Using the ratio of the federal government debt to the revenue collection as an indicator[35], it shows that Malaysia's fiscal space has gradually narrowed since 2012 and became tighter post-pandemic.

The government's medium-term fiscal consolidation plan is guided by its Medium-Term Fiscal Framework (MTFF). Under the latest MTFF for 2023-2025, the government adopted a more conservative estimate from the previous MTFF. It assumes that nominal GDP will expand by an average annual rate of 6 percent, and that the average price of crude oil will stand at US$90 per barrel.[36] As with the previous MTFF, the current framework pursues an expenditure-driven fiscal consolidation. The government expects operating expenditure to decline from 15 percent of GDP in 2023 to around 14.5 percent over the MTFF period. The government also expects revenue to decline over this period, from 15 percent of GDP in 2023 to an average of 14.7 percent in 2023-2025. Overall, the fiscal deficit is expected to consolidate at a gradual pace with the overall balance averaging at 4.4 percent of GDP for the MTFF period.[37]

However, the current fiscal consolidation strategy via spending reduction is challenging, given the current spending rigidity. Firstly, the combined spending on structural expenditures is already at high levels; and secondly, other OE components such as supplies and services, and grants and transfers have been on a declining trend or are already at low levels. As such, the government's current fiscal consolidation plan should also include a higher revenue collection target. With Malaysia's revenue level remaining low and trailing comparative peers, it is important to address the persistent decline in revenue collection and explore new sources of revenue.

35 See Aizenman, Joshua, and Yothin Jinjarak. 2010. De Facto Fiscal Space and Fiscal Stimulus: Definition and Assessment. NBER. (https://www.nber.org/system/files/working_papers/w16539/w16539.pdf). The ratio of the outstanding public debt to the de facto tax base, or the tax-years needed to repay the public debt, provides information about the relative fiscal tightness of countries.

36 In the 2022-2024 MTFF, the government assumes that nominal GDP will expand by an average annual rate of 7.7 percent, and that the average price of crude oil will stand at US$67 per barrel.

37 This would suggest that the fiscal deficit for 2024 and 2025 would have to be lower than 4.4 percent to meet the MTFF target.

Economic Outlook

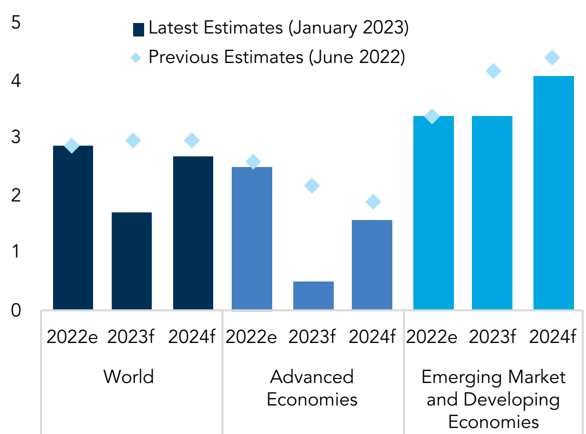
Global growth is expected to slow sharply in 2023

Global growth is forecast to decelerate sharply to 1.7 percent in 2023 (2022e: 2.9 percent), reflecting synchronous policy tightening, worsening financial conditions, and continued disruptions from Russia's invasion of Ukraine (Figure 59). For advanced economies, growth is projected to slow markedly to 0.5 percent (2022e: 2.5 percent) as central banks continue to tighten monetary policy to contain inflationary pressures, labor markets cool, and pressures in energy markets in Europe persist. Activity in EMDEs (Emerging Markets & Developing Economies) excluding China is forecast to slow from 3.8 percent in 2022 to 2.7 percent in 2023 on account of weaker external demand and tighter financing conditions. In 2024, growth in advanced economies and EMDEs are projected to increase to 1.6 percent and 4.1 percent respectively, as price pressures and policy headwinds abate, energy markets stabilize, and external demand gradually improves.

Growth in the EAP region is projected to firm to 4.3 percent in 2023 (2022e: 3.2 percent) as the easing of pandemic-related restrictions allows activity in China to pick up (Figure 60). As mobility restrictions ease, growth in China is forecast to increase from 2.7 percent in 2022 to 4.3 percent this year, still below its potential growth rate owing to lingering stress in the real estate sector. In the region excluding China, growth is projected to moderate to 4.7 percent in 2023 and 2024 (2022f: 5.6 percent) as pent-up demand dissipates and weaker growth of goods exports offset belated recovery in tourism and travel. While recoveries from the pandemic remain incomplete in many countries, with output in 2023 expected to remain significantly below pre-pandemic trends, rising prices for food, energy, and other inputs as well as further monetary policy tightening are envisaged to hold back growth this year, especially for investment.

FIGURE 59
Global growth is projected to decelerate sharply to 1.7 percent in 2023.

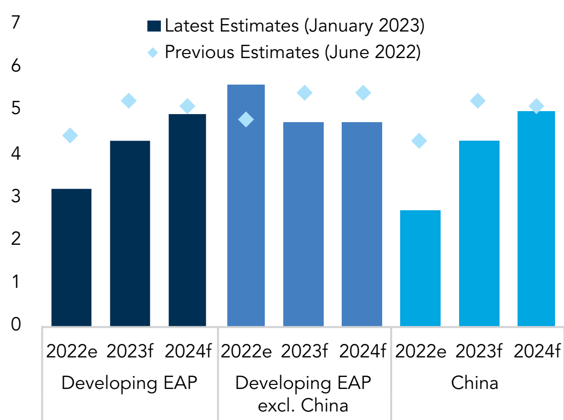
GDP, y/y, percentage



Source: World Bank Global Economic Prospects

FIGURE 60
Aggregate growth in EAP is forecast to firm to 4.3 percent this year.

GDP, y/y, percentage



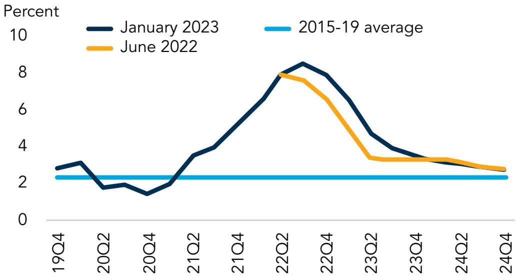
Source: World Bank Global Economic Prospects

Global inflation may be plateauing and is expected to edge down in 2023 and 2024 (Figure 61). In the face of substantial monetary tightening, slowing activity, easing disruptions in global supply chains and moderating prices for many non-energy commodities including food, global inflation appears to be trending down towards the end of 2022, and is expected to ease further over the forecast horizon. Nonetheless, high core inflation in many economies suggests that inflation across both advanced and EMDEs will remain elevated for longer than previous anticipated.

FIGURE 61

Global inflation is projected to edge down over the forecast horizon.

Consumer price inflation, y/y percentage



Source: World Bank Global Economic Prospects

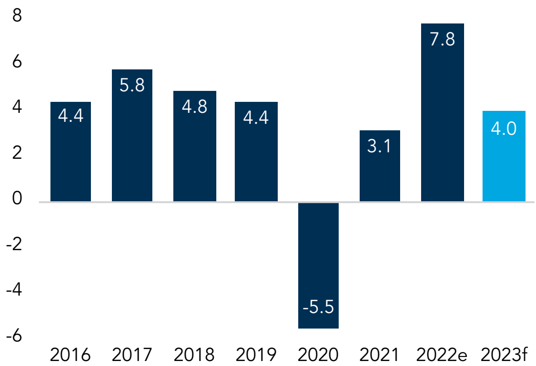
Malaysia's economic growth is expected to moderate in 2023

Malaysia's economy is projected to grow at a more moderate pace of 4.0 percent in 2023, following a stronger-than-expected recovery last year (2022e: 7.8 percent) (Figure 62). The moderation takes into account an expected slowdown in external demand. Nevertheless, domestic private sector spending will remain the main driver of growth (Figure 63). After registering a strong recovery in 2022, private consumption is forecast to expand at a slower but still relatively robust rate of 6.7 percent in 2023 (2022e: 11.2 percent), with growth sustained by improvement in labor market conditions and income prospects, as well as continuous household income support from the government. Meanwhile, public consumption is projected to grow at 2.6 percent this year (2022e: 3.2 percent), reflecting mainly higher emolument spending on account of a special annual salary increment for civil servants.

FIGURE 62

Malaysia's economy is projected to expand at a more moderate rate of 4.0 percent in 2023...

GDP, y/y, percentage

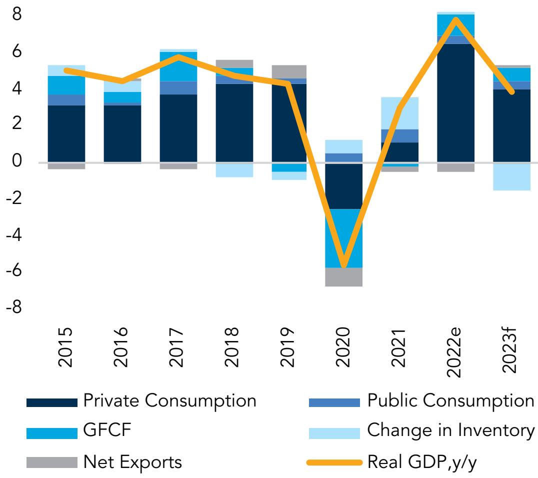


Source: World Bank Global Economic Prospects

FIGURE 63

... driven mainly by domestic private sector spending.

GDP, y/y, percentage



Source: World Bank Global Economic Prospects

Gross fixed capital formation (GFCF) is projected to increase by 4.2 percent in 2023 (2022e: 5.3 percent), reflecting the continued flows of capital investments in the private and public sectors. Capital expenditure in the private sector will continue to be driven by ongoing and new multi-year investments in the technology-intensive manufacturing and services sectors. However, persistent uncertainty around the external environment and tightening financial conditions could weigh on investment intentions, particularly among export-oriented firms. Capital spending by the government is expected to be mainly directed towards upgrading of public infrastructure and amenities, while investment activity by public corporations will be largely supported by the implementation of existing and new transportation infrastructure projects, including ECRL, LRT3, MRT3, RTS Link, Sarawak-Sabah Link Road Phase 2, and Trans Borneo Highway.

Trade growth is expected to moderate in 2023 as the global environment becomes less supportive. After a strong performance in 2022 (2022e: 13.2 percent), Malaysia's export growth is projected to slow to 2.2 percent this year, in line with softening global growth prospects and weakening international trade momentum. Similarly, import growth is projected to moderate to 2.1 percent in 2023 (2022e: 15.3 percent). This reflects the slower import growth across consumption, intermediate, and capital goods, consistent with a more moderate pace of expansion in consumer spending, exports, and investment activity.

Headline consumer price inflation is projected to moderate somewhat to between 2.5 and 3.0 percent in 2023 (2022e: 3.3 percent) as global supply constraints ease and commodity prices stabilizes. This forecast is premised on the assumption that the ceiling on retail fuel prices and price control measures on selected food items remain in place throughout the year, limiting cost pressures from the prevailing global oil and food prices. Meanwhile, underlying inflation, as measured by core inflation, is expected to remain at around 3 percent this year. This reflects the broadening of cost pressures from the prevailing commodity prices and the pass-through of upstream cost pressures to consumer prices, continuing strengthening of domestic demand, and narrowing degree of spare capacity in the economy.

TABLE 3
Malaysia's economy is expected to expand at a more moderate pace in 2023, driven mainly by domestic private sector spending.

Annual Growth, y/y, Percentage					Contribution to annual GDP Growth (Percentage Point)				
	2020	2021	2022e	2023f		2020	2021	2022f	2023f
GDP	-5.5	3.1	7.8	4.0					
Domestic Demand (including stocks)	-4.9	3.6	8.9	4.0	Domestic Demand (including stocks)	-4.6	3.4	8.3	3.8
Private Consumption	-4.2	1.9	11.2	6.7	Private Consumption	-2.5	1.1	6.6	4.1
Public Consumption	5.0	5.3	3.2	2.6	Public Consumption	0.6	0.7	0.4	0.3
Gross Fixed Capital Formation	-14.4	-0.9	5.3	4.2	Gross Fixed Capital Formation	-3.3	-0.2	1.1	0.8
External Demand					External Demand				
Exports of Goods & Services	-8.6	15.4	13.2	2.2	Exports of Goods & Services	-5.5	9.5	9.1	1.6
Imports of Goods & Services	-7.9	17.7	15.3	2.1	Imports of Goods & Services	-4.5	9.8	9.7	1.4

Source: World Bank staff calculations and projections

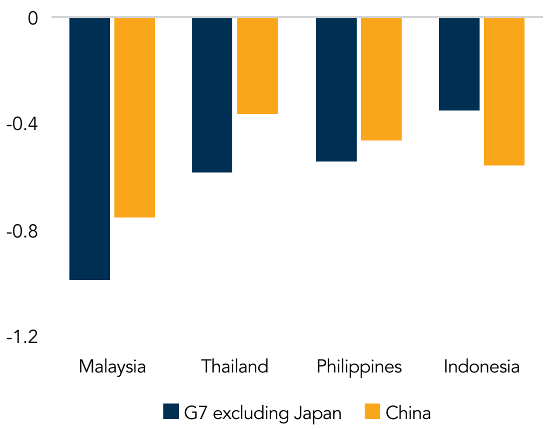
Malaysia's growth outlook is subject to considerable uncertainty

As a highly open economy, Malaysia will continue to face substantial risks emanating from the external environment. Further adverse shocks to global growth – including higher-than-expected inflation, tighter financial conditions, deeper slowdown in major economies, a prolonged war in Ukraine, and prolonged real estate sector weakness in China – could cause a sharper-than-expected slowdown in global growth. The materialization of these risks could have negative spillovers to Malaysia given its high level of integration with the global economy and financial markets. It is estimated that a 1 percentage point decline in GDP growth of the G7 economies and China could cut 1 and 0.7 percentage point, respectively, off growth of the Malaysian economy (see Figure 64).[38]

FIGURE 64

The slowdown in major economies could cut close to 1 percentage point off growth of the Malaysian economy.

Impact of a 1 percentage point decline in the G7 (excl. Japan) and Chinese GDP growth rate, y/y, percentage point



Source: World Bank Global Economic Prospects

On the domestic front, the main sources of downside risk relate to the uncertainty surrounding inflation and relatively high debt levels. Broader and more persistent price pressures in Malaysia – potentially due to changes to domestic policy measures - may necessitate further monetary policy adjustments to dampen domestic demand over the near term. A decline in real disposable household incomes from higher prices could also weigh on the strength of consumer spending by more than currently assumed, particularly for low-income households which have been disproportionately impacted by the recent price increases. The relatively high levels of non-financial corporate (H1 2022p: 104.4 percent of GDP) and household debt (H1 2022p: 84.5 percent of GDP) amid tightening financial conditions may weigh more heavily on private investment and consumption. This continues to pose risks to macro-financial stability. Nevertheless, the domestic banking systems have remained operationally resilient against these risks and continue to extend support to viable borrowers. In addition, rising uncertainty over global economic developments could also lead to higher financial volatility could also lead to large portfolio reversals in the domestic financial markets. This could temporarily push up borrowing costs. However, the presence of large, domestic institutional could help to mitigate sharp increases in borrowing costs.[39] The international reserves remain stable with reserves position sufficient to finance 5.3 months of imports of goods and services and is 1.1 times of the total short-term external debt as of December 2022.

38 Source: October 2022 World Bank East Asia and Pacific Economic Update: Reforms for Recovery.

39 See World Bank (2022) "Catching up: Inclusive Recovery & Growth for Lagging States" Malaysia Economic Monitor (June), World Bank, Washington, DC.

Near-term policy measures should focus on supporting the vulnerable and rebuilding fiscal buffers

Expenditure on targeted social safety net programs could be increased. Putting in plans to phase out blanket, broad-based subsidies and move towards a more targeted subsidy framework that would benefit lower income households is relevant and timely. The shift towards a targeted framework should also be gradual, as a sudden and abrupt complete removal could lead to a sharp increase in inflation (see Box 5 on Analysis on Sudden Fuel Subsidies Removal). In addition, the mechanics should also be implementable in a way that minimizes transaction costs.

There is an urgent need to understand and properly measure poverty and inequality so that responses and policies can be rolled out more effectively and equitably. Aside from bringing negative economic consequences to the fore in its initial stages,[40] the pandemic also highlighted the stark inequalities that exist beyond simple monetary measures. The government is currently considering an update of its poverty line income and multidimensional poverty index. This is not only timely but also critically important to improve poverty measurement to a standard commensurate with Malaysia's current living standards and state of development. This will help to ensure that economic growth and rising living standards can occur in a context that allows for an evolving concept of what it means to be poor, with a new set of development priorities that lead to inclusive growth.[41] In the same spirit, the government may wish to revisit the current narrow focus on 'hardcore poor', as it misses out many vulnerable groups, such as informal and younger workers. As such, the strategies identified in the 12th Malaysia Plan to eradicate hardcore poor should therefore be expanded to include absolute poor and vulnerable groups.[42]

The government's current medium-term fiscal consolidation plan should also include raising its revenue collection. Currently, the government's fiscal consolidation projects government revenue to decline further from 15.0 percent of GDP in 2023 to an average of 14.7 percent in the medium-term. With Malaysia's revenue level remaining low and trailing comparative peers, it is important to address the persistent decline in revenue collection and explore new sources of revenue. As such, efforts to rebuild fiscal space and increase it would have to be driven by both higher revenue collection and better spending efficiency. The government is currently finalizing its Fiscal Responsibility Act (FRA), and this should include detailed plans on measures to diversify its revenue sources. Consideration should be given to streamlining reliefs and broadening the tax base of personal income tax and by enhancing the consumption tax framework.[43]

40 The pandemic is estimated to push an additional 230,000 households into poverty (based on income poverty line) in 2020, while income inequality measured by Gini index increased slightly from 40.7 percent in 2019 to 41.1 percent in 2020. *Source*: Department of Statistics Malaysia, 2021, Household Income Estimates and Incidence of Poverty Report 2020

41 Murgai, Rinku and Hassan Zaman. Setting standards: Why updating poverty lines matters in East Asia. https://blogs.worldbank.org/eastasiapacific/setting-standards-why-updating-poverty-lines-matters-east-asia

42 The 12th Malaysia Plan identified broad spectrum of strategies to eliminate hardcore poverty by 2025 which many are relevant to assist absolute poor households and vulnerable groups, such as uplifting and diversifying income, improving provision for quality education and skills training, improving communication services, among others.

43 See Malaysia's Consumption Tax Systems: Challenges and a Path Forward. World Bank: Malaysia Economic Monitor, Staying Afloat (December 2021).

PART TWO

Expanding Malaysia's Digital Frontier


ON
OFF
ON

Expanding Malaysia's Digital Frontier

The COVID-19 pandemic accelerated digitalization in Malaysia, with digital platforms and services helping to reduce the economic, social, and health costs of the pandemic. While this trend was already underway in Malaysia in recent years, the greater availability of digital products and services, across a wide range of sectors, during the pandemic played an important role in maintaining economic activity amidst lockdowns, social distancing, and other mobility restrictions. Digitalization also helped to increase the efficiency of public response during the pandemic and recovery period. Moreover, during the pandemic period, digitalization supported expanded market access for many businesses and consumers, by reducing the need for face-to-face interaction.

Globally, there is growing evidence that digital technologies can contribute to growth, productivity, employment, and poverty reduction—key elements to support the Malaysian recovery. In addition to contributing to economic and social resilience, economic literature shows that digital connectivity and services can further countries' longer-term economic development.[44] Digitalization is a key driver of total factor productivity (TFP), of critical importance to Asian countries[45] like Malaysia where productivity growth had been lagging its aspirational peers even before the pandemic.[46] Digital platforms leverage network externalities, data, and disruptive technologies to enable market efficiencies, increase welfare for consumers, and boost productivity for businesses.[47] In several African countries, studies document the link between improvements in digital infrastructure, such as enhanced connectivity and a reduction in extreme poverty[48] and inequality.[49] This is highly relevant as the pandemic pushed an additional 230,000 households into poverty and increased income inequality in Malaysia.[50]

Key Malaysian policy documents stress the importance of digitalization to achieve the country's developmental objectives. Among these strategic documents are the 12th Malaysia Plan (2021-2025), the Malaysia Digital Economy Blueprint (2021), the Financial Sector Blueprint (2022-2026) and the Public Sector Digitalization Strategic Plan (2021- 2025). Each of these documents set forth the country's key strategies and planned activities to achieve its main set developmental targets.

Malaysia can maximize the opportunities brought on by the greater digitalization trend post-pandemic while managing risks. Developing an inclusive, dynamic, and safe digital economy involves building solid foundations in five priority policy areas (Figure 65): (i) digital infrastructure, (ii) digital platforms, (iii) digital financial services; (iv) digital literacy and advanced digital skills, and (v) digital safeguards, such as data protection and cybersecurity. In addition, there is an important cross-cutting focus on data access and availability. These policy priorities are adapted from the Development Committee Ministerial Plenary Paper (2022).

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44 A growing volume of over 100 academic research papers provides increasingly robust evidence that digital connectivity contributes to a wide range of positive economic outcomes, including growth, employment, and poverty reduction as summarized in the World Bank *Development Committee Ministerial Plenary Paper, Spring Meetings 2022.*

45 IMF Departmental Papers, 2023. Accelerating Innovation and Digitalization in Asia to Boost Productivity. January.

46 World Bank, 2019. "Aiming High: Navigating the Next Stage of Malaysia's Development.

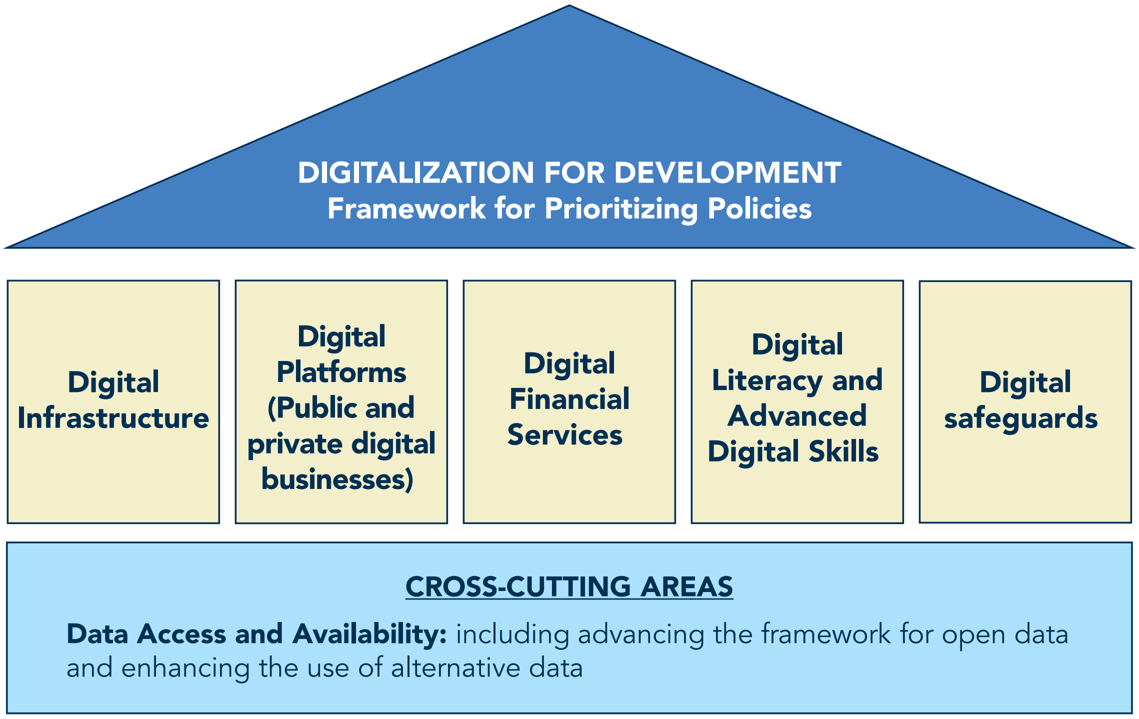
47 World Bank *Development Committee Ministerial Plenary Paper, Spring Meetings 2022.*

48 Masaki et. al, 2020. "Broadband internet and Household Welfare in Senegal."

49 Policy Research Working Paper. 9853. The Impact of Digital Infrastructure on African Development. César Calderón. Catalina Cantú. Africa Region

50 Department of Statistics Malaysia, 2021, Household Income Estimates and Incidence of Poverty Report 2020

FIGURE 65
Maximizing the developmental dividends of digitalization requires five priority policy areas.



Source: Adaptation from World Bank Development Committee Ministerial Plenary Paper, Spring Meetings 2022.

The pandemic accelerated digitalization in Malaysia

The growth of the Malaysian digital economy accelerated during the pandemic period. Based on Information and Communication Technology Satellite Account by Department of Statistics Malaysia, the ICT sector grew at 10.6 percent in 2020 and 12.1 percent in 2021, reaching RM359.3 billion in value added. The contribution of the ICT sector increased from 19.2 percent of GDP in 2019 to 23.2 percent in 2021 (Figure 66). The ICT Technology Satellite Account comprises two major components: Gross Value-Added ICT industry[51] (GVAICT) and E-Commerce of other industries. The contribution of the GVAICT to GDP has remained relatively stable at 14.2 percent 2020 and 14.0 percent in 2021[52], while the contribution of E-Commerce of other industries has increased from 8.4 percent in 2020 to 9.2 percent of GDP in 2021.

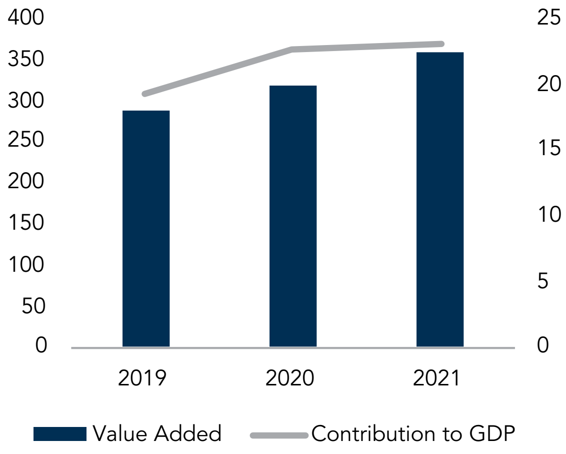
51 Gross Value Added ICT industry includes ICT services, ICT manufacturing, ICT Trade and Content & Media.

52 Nevertheless, GVAICT actually still grew at 7.8 percent in 2021 compare to 3.2 percent a year before.

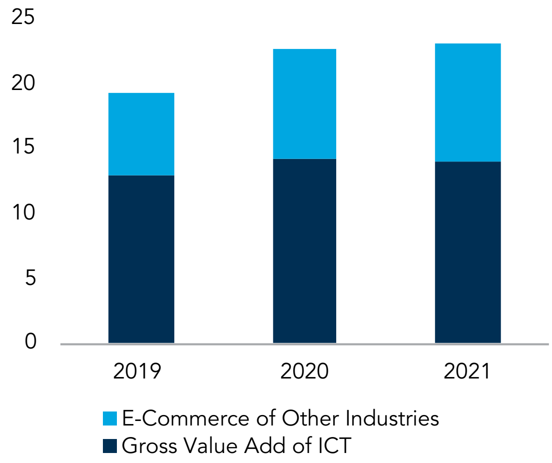
FIGURE 66

In Malaysia, the digital economy expanded during the pandemic crisis.

GDP in RM billion, Contribution of ICT to the economy (GDP), percentage



Contribution of ICT and other e-commerce as a share to GDP, percentage



Source: World Bank staff calculations based on DOSM data

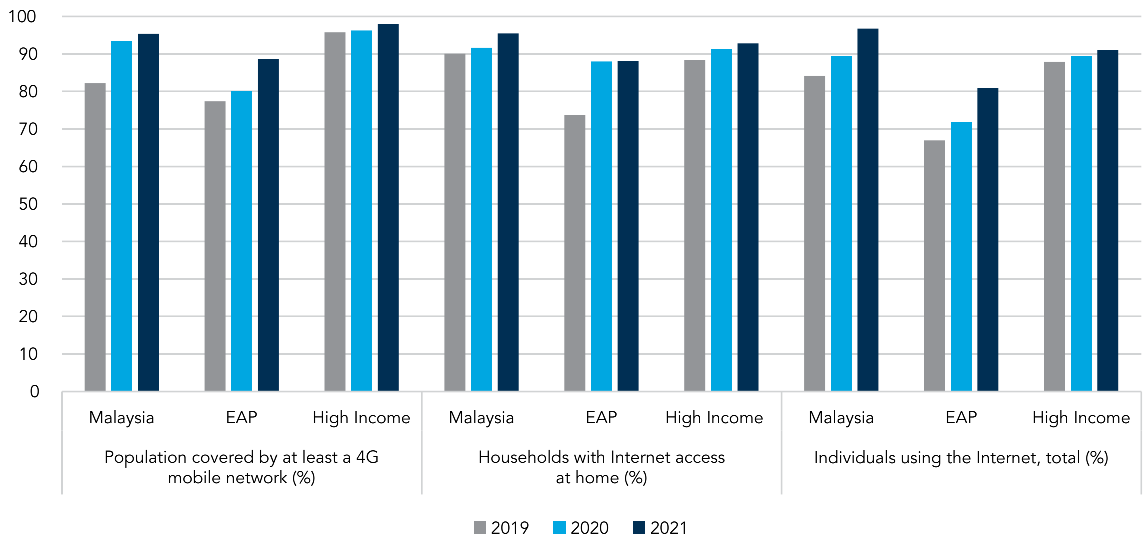
Widespread digital connectivity

In Malaysia, the pandemic crisis triggered a rapid expansion in access and usage of internet. According to data from the International Telecommunication Union (ITU), almost 97 percent of individuals used the internet in 2021, up from 84 percent in 2019 (Figure 67). This is highly relevant for the development of a digital economy because ICT infrastructure is one of its basic foundational aspects. Digital products and services are highly dependent on widespread access to the internet and on mobile phone ownership, which, in turn, depend on the existence of more basic infrastructure elements, such as a reliable power supply and cable infrastructure.

FIGURE 67

In Malaysia, the pandemic crisis triggered a rapid expansion in access and usage of internet.

Internet availability, access, and usage, percentage



Source: ITU 2022

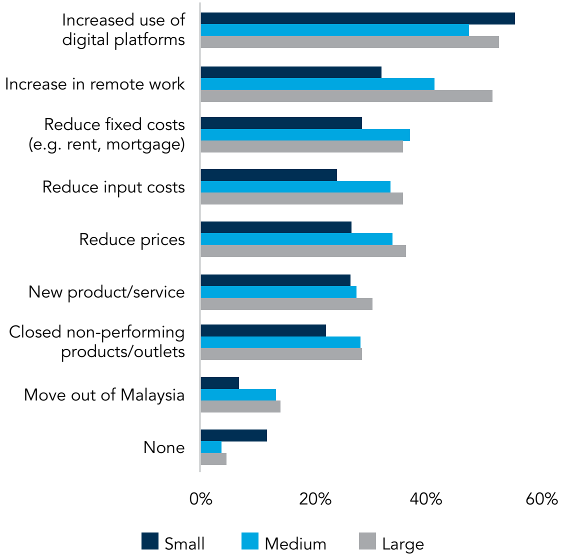
Increase in business digitalization

The pandemic has also accelerated the pace of digitalization among firms in Malaysia. The World Bank's Business Pulse Survey (BPS), in the "Digitalizing SMEs to Boost Competitiveness" report (World Bank, 2022c), shows that Malaysian businesses' most common adjustment strategy during the pandemic was to increase their adoption of digital platforms (Figure 68).[53] While digital platform adoption took place across firms of all sizes, SMEs often started from lower levels of digital adoption and used less complex digital solutions than larger enterprises. Moreover, there were marked differences in how firms of different sizes increased their usage of digital platforms. In the case of small businesses, the increased use of digital modalities has mostly been for customer-facing business functions (e.g., marketing, and social media presence) (Figure 69). Few SMEs have leveraged more complex productivity-enhancing solutions to transform their business operations or are able to conduct end-to-end digital transactions. In contrast, firms using digital solutions for production/supply chain management tend to be larger (BPS surveys).

FIGURE 68

Most common adjustment strategy during the pandemic was to increase adoption of digital platforms.

Share of adjustment strategy of firms, percentage

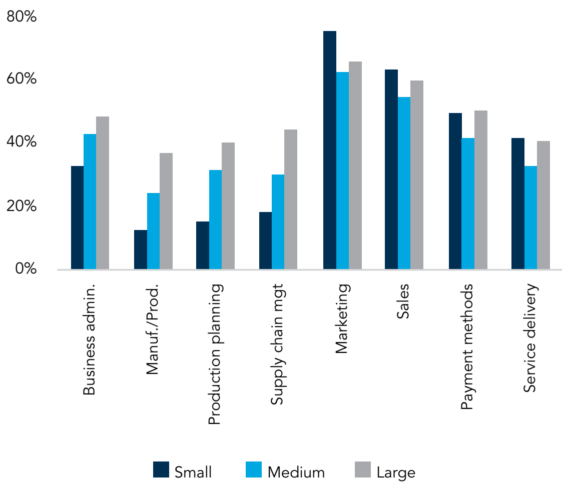


Source: BPS in World Bank (2022c)

FIGURE 69

The increased use of digital modalities has mostly been applied to customer-facing business functions.

Share of digital use by business functions of firms, percentage



Source: BPS in World Bank (2022c)

Trade in digital services has also been growing rapidly over the past few years and was bolstered by the COVID-19 pandemic. The increased digitalization of businesses in Malaysia has created new trade opportunities by giving access to remote and foreign markets to firms of all sizes, and by lowering trade costs and expanding the variety of goods and services that can be traded. World Bank (2022b)[54] shows that while global digital trade is currently dominated by high-income countries, emerging economies such as Malaysia are increasingly engaging and investing in the expansion of digital trade as exporters of high-value digital services. For example, the share of digitally deliverable services in total services exports has grown, especially in response to COVID-19, at almost 50 percent of the total in 2020 in Malaysia, up from 22 percent in 2010, but still lagging regional peers (58 percent in 2020). However, aspects of Malaysia's environment for competition may be inhibiting the deepening of foreign linkages. For example, Malaysia imposes substantial foreign entry restrictions into its digital network services sub-sectors, with the 2020 OECD Services Trade Restrictiveness Index finding restrictions for the telecommunications sector particularly high relative to its peers (World Bank 2022b).

53 Similar patterns were observed in other countries where the BPS survey was conducted (World Bank 2022c).

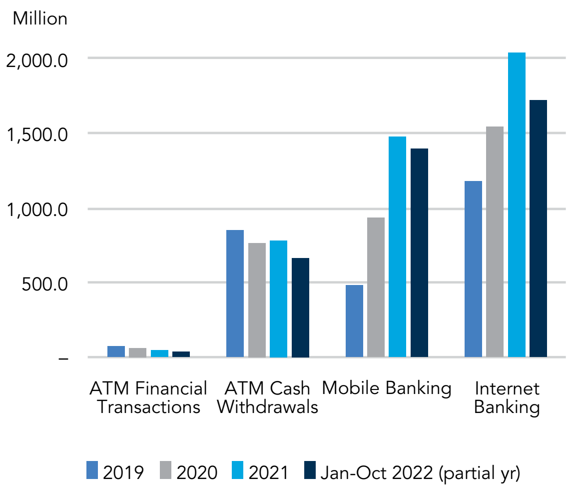
54 See World Bank (2022b) "Deep-Dive on Malaysia's Digital Services Trade."

Increase in digital payments

The adoption of digital platforms in Malaysia is leading a greater usage of digital payments. BPS data (World Bank 2022c) show digital platforms for payments and sales will continue to be an essential enabler for the digital economy. The adoption of digital technologies is considered permanent by most firms, with a tiny fraction (between 2% and 5% of firms across different business functions), stating that they would revert to pre-pandemic manual systems (BPS survey Feb 2022). More broadly, 2021 World Bank Global Findex data show that digital payment volume increased sharply in Malaysia during the pandemic (Figure 70), with about 5 million Malaysians (about 20 percent of the adult population) reporting they made their first digital merchant payment after the COVID-19 pandemic began. As shown in Figure 71, the share of Malaysians using digital payments increased in 2021 to 79 percent, up from 63 percent in 2014, to 70 percent in 2017, comparing favorably to the East Asia and Pacific region overall. In addition, mobile money account ownership increased from just 3 percent of adults in 2014 to 11 percent in 2017 to 28 percent in 2021 (World Bank, forthcoming).[55]

FIGURE 70
The number of transactions through digital channels increased sharply....

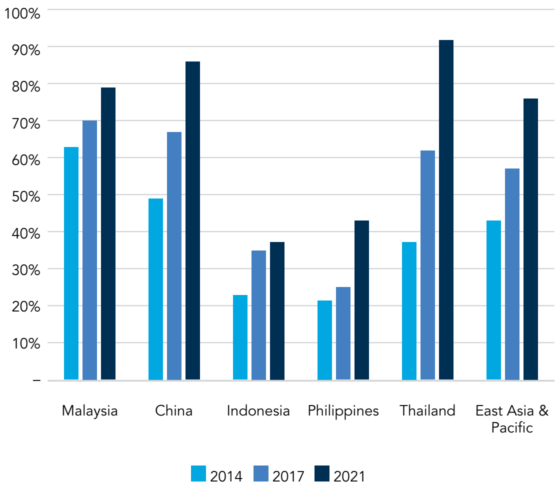
Transaction volume by payment channels



Source: World Bank staff calculations of BNM data 2022

FIGURE 71
...as did the share of Malaysian adults using digital payments.

Adults that made received digital payments last year, percentage



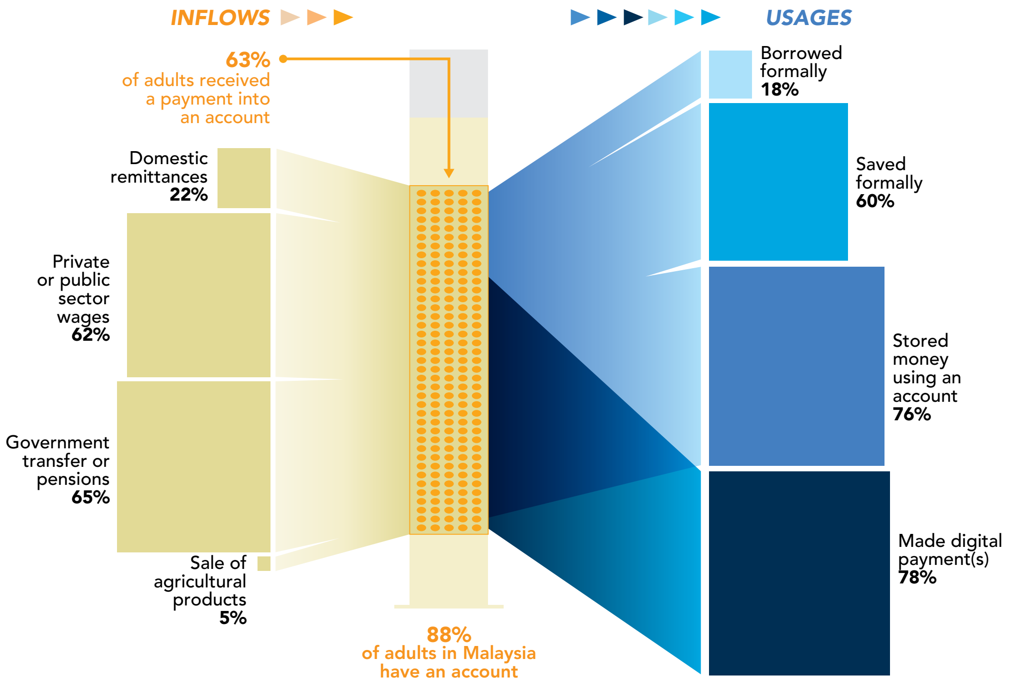
Source: World Bank staff calculations of WB Global Findex Database 2021

Digital payments are an important entry point for Malaysians to use other types of digital financial services and more broadly in the digital economy. For example, Figure 72 shows that Malaysians who received a digital payment into an account, 78 percent reported that they also made a digital payment, such as: digital merchant payments (made by 62 percent), bill payments (48 percent), a utility payment (46 percent), or domestic remittance payments (24 percent). Importantly, more than 3 in 4 adults who received a digital payment into their account also used the account to store money, and about 60 percent of payment recipients saved money formally and 18 percent borrowed money formally (World Bank, forthcoming). In addition, overall financial account ownership inched upwards from 85 to 88 percent in 2021, indicating that the share of unbanked has not decreased much despite the increased use of digital financial services (World Bank Global Findex 2021).

55 Mobile money products included in the 2021 Global Findex survey were Celcom AirCash, Valyou Wallet, and Touch and Go e-wallet.

FIGURE 72

Payments can be a gateway to engagement in the digital economy.



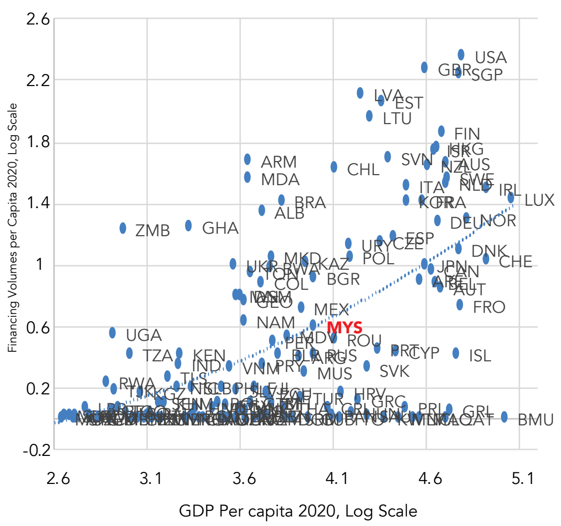
Source: World Bank staff calculations of WB Global Findex Database 2021

FIGURE 73

Financial transaction volumes through fintech platforms in Malaysia comprise mostly digital payments, suggesting there is significant opportunity to expand the range of digital financial services offered through fintech platforms.

A. Fundraising activity through Fintech platforms in Malaysia is comparable to other middle-income countries.

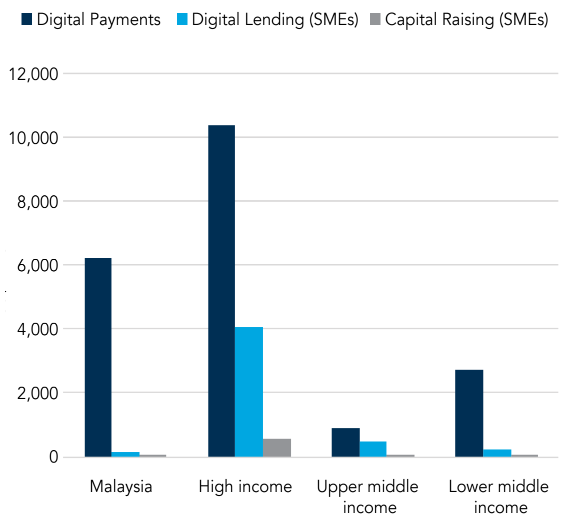
Financing volumes in fintech platforms in 2020, percentage



Source: The 2nd Global Alternative Finance Market Benchmarking Report, 2021

B. Digital payments account for the bulk of financial transactions through fintech platforms in Malaysia.

DFS through fintech platforms in 2020



Source: CCAF-World Bank Global COVID-19 Survey of Fintech Market Impact and Industry Resilience study 2021

Despite a marked expansion in digital payments in Malaysia, there is still significant opportunity to expand the range of digital financial services offered through fintech platforms, thereby expanding their usage. For example, there has been a marked increase of 34 percent in the usage of fintech platforms for financial transactions (CCAF-World Bank, 2022). In Malaysia, alternative financing volumes through fintech platforms (comprising only digital lending and capital raising activities) is comparable to that of other middle-income countries (Figure 73A).[56] However, a broader survey including other financial transactions conducted through these platforms shows that digital payments dwarf fundraising transaction volumes in Malaysia, much more so than in other middle-income countries. That is, alternative financing transactions are concentrated in digital payments (Figure 73B). For example, about 98 percent of the transaction volumes in Malaysia represent digital payments, in comparison to 42 percent in high-income countries, 53 percent in upper middle-income countries, and 79 percent in lower middle-income countries.

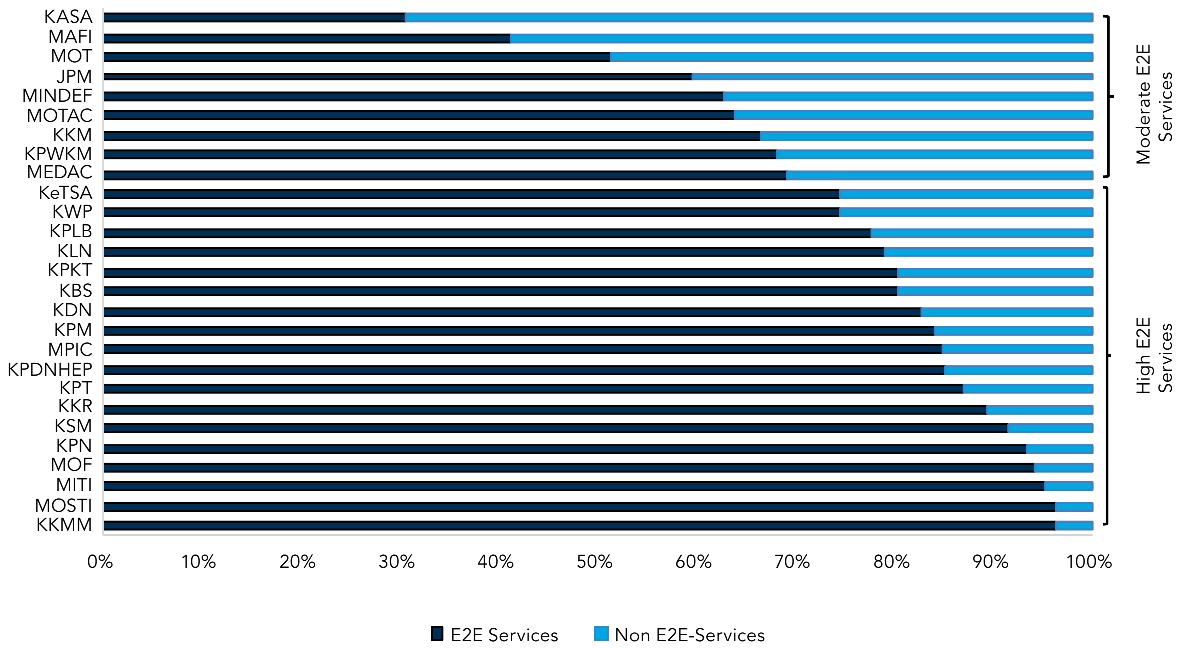
Increase in digital government services

Malaysia has advanced in the digitalization of government services. The government recently rolled out national policies and blueprints on digital government, which indicates a strong commitment to further intensify digitalization of government services and citizen centric decision-making.[57] In the aftermath of the COVID-19 outbreak, the number of visitors to the My Government Portal—the single gateway for government's online services—grew from 2 million visitors in 2019 to 6.15 million visitors in 2021. Although there is variation across government agencies, many ministries reported that between 70 and 90 percent of their services are end-to-end (E2E) online services or fully digitalized in 2021 (Figure 74). Moreover, about 78 percent of federal ministries, departments and statutory bodies offer cashless payment options. Ministries and agencies have also started to utilize MyGDX, a sharing platform to facilitate the provision of end-to-end online services and allow information to be coordinated and shared efficiently.[58]

FIGURE 74

Many ministries reported that 70 to 90 percent of their services are end-to-end (E2E) online services or fully digitalized in 2021

Share of advancement of End-to-End Digital Services by government ministries, percentage



Source: MyGovernment portal, 2019-2021

56 The financing volumes shown in Figure 73A comprise all types of financing through fintech platforms, including consumer lending. However, Malaysia does not have any operating platform offering P2P consumer lending.

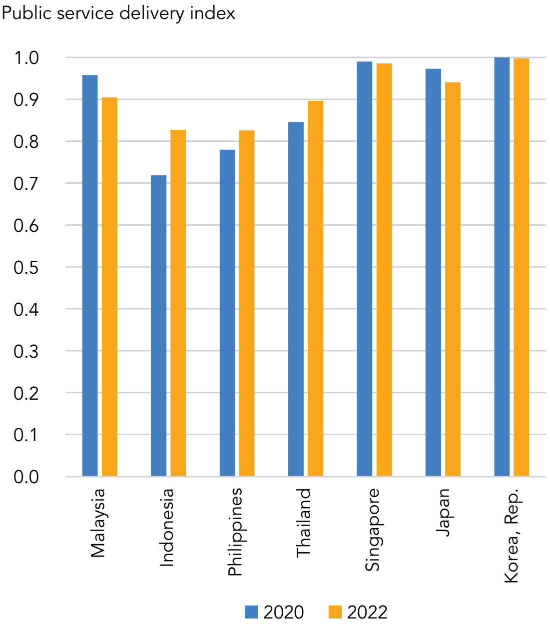
57 For example, the Malaysia Digital Economy Blueprint (2020), the Public Sector Digitalization Strategic Plan (PSDSP) 2021- 2025, and the 12th Malaysia Plan (2021-2025).

58 See MyDigital Corporation Progress Report (2021).

E-government development in Malaysia compares relatively well with regional peers, though there is room for improvement in digital service delivery when compared with high income countries. For example, the Public Service Delivery Index, a component of the World Bank GovTech Maturity Index, captures the state of online portals, e-filing services, e-payment capabilities, among others.[59] Malaysia is ranked 51st (out of 198 economies), outperforming Indonesia and the Philippines and on par with Thailand, but with less developed e-government services than Republic of Korea and Singapore (Figure 75).

FIGURE 75

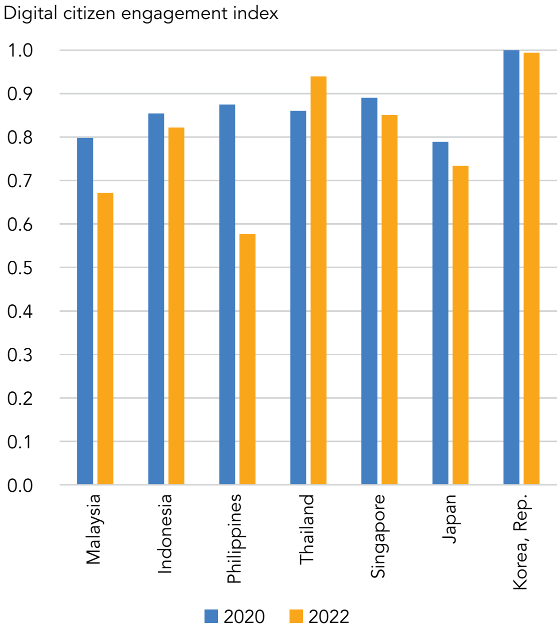
E-government development in Malaysia compares relatively well with regional peers.



Source: World Bank GovTech Dataset (2022)

FIGURE 76

Malaysia's trails regional peers and high-income countries in adoption of citizen-centric digital solutions.



Source: World Bank GovTech Dataset (2022)

However, a key challenge for Malaysia is the adoption of citizen-centric digital solutions. For example, the Digital Citizen Engagement Index, also a component of the World Bank GovTech Maturity Index, measures aspects of public participation in platforms, citizen feedback, and open gov/data portals. Malaysia's rank is lower in this case, behind regional peers and high-income countries, suggesting a lack of systematic engagement with citizens at design, execution, and monitoring of quality of digital services (Figure 76).

59 The World Bank GovTech Maturity Index (GTMI), which is a broader measure of the extent of digital transformation in the public sector capturing digitalization of core government systems, citizen engagement, and a wide range of GovTech enablers, show that Malaysia outperforms regional peers, while being on par with OECD countries.

At the same time, the pandemic also exposed Malaysia's digital divide

Although the pandemic crisis has fostered greater digitalization, it has also exacerbated a digital divide—that is, inequalities in access to and usage of digital products and services.[60] Despite the pressure to embrace digital technologies and platforms during the pandemic crisis, the digitalization trend has been unequal across firms and subgroups of the Malaysian population, with certain segments less likely to have access to the necessary infrastructure and/or the capabilities to utilize these technologies. Disparities have been observed for example among smaller firms, poorer individuals, those living in more rural areas and in certain states.

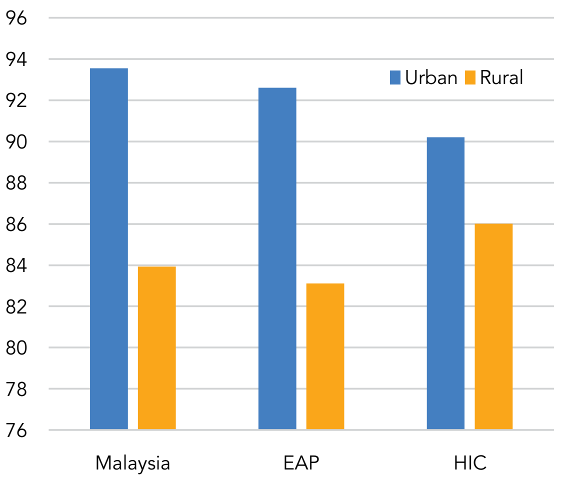
Gaps in connectivity

In Malaysia, there are marked differences in internet usage across regions. For example, there is a rural-urban gap of about 10 percentage points in household usage of internet (Figure 77). This gap is comparable to the average observed in the EAP region but is significantly wider than that in high-income countries. Among firms, there are similar disparities in usage across states, with firms in states with higher GDP per capita generally displaying greater usage of ICT than others. For example, the share of firms not using the internet is very low in the Central States, Penang, and Melaka, but over 25 percent in nine other states and territories (Figure 78).

FIGURE 77

There is a rural-urban gap of about 10 percentage points in household usage of internet.

Share of households with internet access at home, percentage 2020

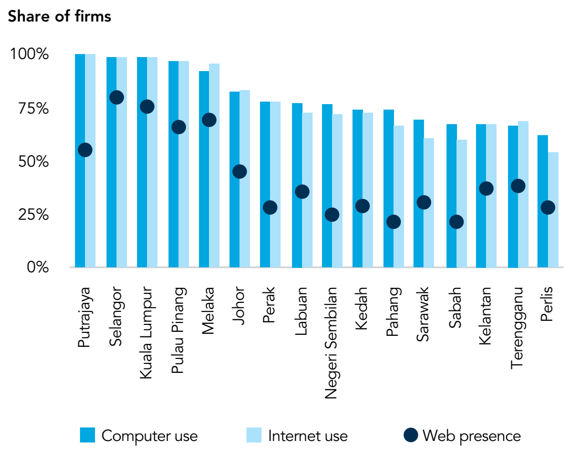


Source: ITU Digital Development Dashboard, 2022

FIGURE 78

Firms in higher GDP per capita states generally display greater usage of ICT than others.

Regional variation in ICT uses, share of firms, percentage 2019



Source: DOSM in World Bank (2022c)

60 Income inequality measured by Gini index increased slightly from 40.7 percent in 2019 to 41.1 percent in 2020. *Source*: Department of Statistics Malaysia, 2021, Household Income Estimates and Incidence of Poverty Report 2020.

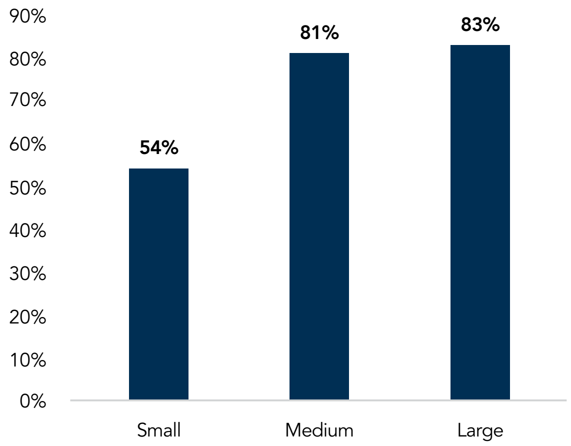
Gaps in digitalization across firms

Fewer SMEs than large firms in Malaysia have been able to turn to advanced digital solutions to cope with the COVID-19 crisis (World Bank 2022c). SMEs are more likely to digitalize basic customer facing business functions and larger firms were more likely to invest in digital solutions than smaller ones—more than 80 percent of medium and large firms invested in digital solutions compared to 54 percent of small firms (Figure 79). Additionally, the value of investment in digital solutions relative to their sales also commensurate with the size of the business. On average, large firms invest five times more relative to their sales revenues than small ones (World Bank 2022c). Moreover, larger businesses invested in digital solutions covering wider business functions, including more advanced backend functions (BPS Surveys).

FIGURE 79

Larger firms were more likely to invest in digital solutions than smaller ones.

Share of firms investing in digital solutions, by size

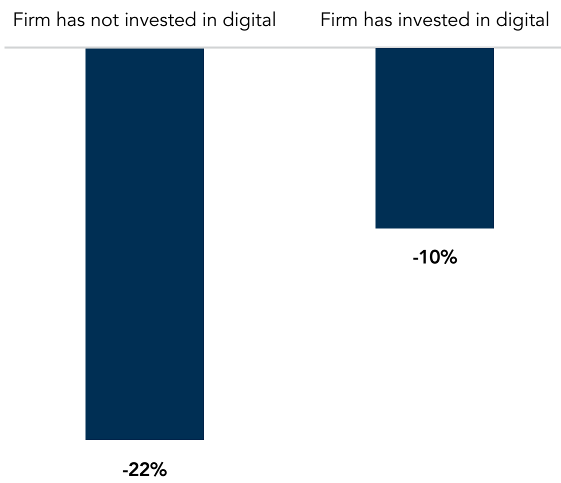


Source: BPS in World Bank (2022c)

FIGURE 80

Firms that had not reported investments in new digital solutions to cope with the pandemic had a larger decline in sales.

Average change in sales, percentage



Note: Controlling for firm size, sector, and region

Source: BPS in World Bank (2022c)

Importantly, enterprises that invested in digital solutions throughout the pandemic were more resilient and better able to cope with the challenges brought on by the pandemic. The evidence from BPS suggests that large firms have been relatively more capable of leveraging their investments in digital solutions into higher sales. In the case of large firms, the proportion of sales conducted through e-commerce increased from 29 percent before the pandemic to 34 percent after its onset, whereas sales increased by only 1 to 2 percentage points in the case of small and medium-sized firms. Moreover, firms that reported investments in new digital solutions coped better with the pandemic, recording a decline in sales that was 12 percentage points lower than those that did not (Figure 80). Box 7 further discusses the experience of the agricultural sector with digitalization.

BOX 7

Digitalization of Agriculture: Challenges and Opportunities for Malaysia

The digital revolution can build an agriculture and food system that is efficient, environmentally sustainable, and equitable, but in Malaysia the experience so far is mixed. Malaysian agri-food companies have relatively high state ownership and are domestic market-oriented. Challenges include: (i) low agricultural productivity, (ii) imperfect competition, and (iii) suboptimal utilization of technology and Research and Development (R&D). Overall labor productivity growth in the agriculture sector is negative (-1.7 percent) in Q1 2022 and well below the Malaysian average of 2.1 percent, on the back of low sector employment declining by 0.7 percent. Malaysian agri-food companies are constrained by problems of reliable access to electricity and power outages, and access to broadband is often limited, which is an obstacle to boost productivity and supply reliability. R&D spending on the agri-food sector is low, and so is the adoption of new technologies and improved process flows, with less than 15 percent of firms spending on R&D and having internationally recognized qualifications or certifications.

Malaysia is advanced in many aspects related to digitalization, but digitalization varies regionally. Some examples of digitalization are having an impact on the agriculture sector, but the full potential of these benefits (ex: faster information flows, reduced transaction costs, increased efficiency, streamlining of circular economy-based solutions) have yet to be realized at the national level. Digitalization features in some of the Ministry of Agriculture and Food Security's (MAFS's) flagship initiatives, including the innovative Smart-Sawah Berskala Besar currently focused on Integrated Agricultural Development Areas.

Encouragingly, at the national and subnational level, there are examples of policies, enabling environment, and complementary investments that have helped to steer and accelerate the digital transformation of the agri-food system. At the national level, agriculture is included under the National Fourth Industrial Revolution (4IR) Policy as one of the priority sectors. The application of 4IR technologies in the agriculture sector is anticipated to create the highest impact on the nation as a whole. Some of the important policies undertaken by the Malaysian Govt under the 4IR include: (i) creating more local digital platforms to enable Farm-to-Table digital marketplace; (ii) investing in basic infrastructure in rural areas to enable the adoption of 4IR technologies; (iii) establishing the 4IR agriculture technology application center and agriculture facilitation fund to encourage the adoption of emerging technologies; (iv) setting up-regulated co-investment trust fund to pool capital from the government and the private sector to invest in 4IR-related technologies; and (v) providing tax incentives to encourage the adoption of 4IR technologies. At the sub-national level, In Sarawak, in line with the Digital Economy Blueprint, the government created an enabling policy and regulatory environment for digital platforms, digital entrepreneurship, digital payment systems, and digital skills. There are zones dedicated to high-profile technology parks for food crop production. Johor is preparing the Johor Agrofood Policy 2021-2030 (DANJ), and to promote food security and digital technologies it leverages a Smart Agriculture Zone (SAZ) and a Drones & Robotics Zone (DRZ) in the city of Iskandar.

Overall, fostering the adoption of technology, innovation, and modernized management practices is necessary for the agri-food sector to improve its performance. In the past, Malaysia has done relatively well in developing new products, but its performance has fallen short in the introduction of process improvements. This status quo is further compounded by underinvestment in R&D. For example, Malaysian agri-food producers embrace digital sales channels, but rely on traditional modes of communication with customers and non-digital payment modes. A long-term vision is needed for digital agriculture that would include: (i) spatial and temporal considerations to guide future development, (ii) consideration of changing diets and nutritional requirements, and (iii) steps to improve resilience.

Gaps in digital financial services

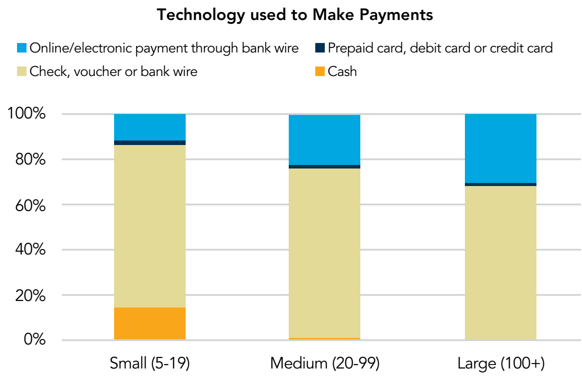
Notable gaps in the usage of digital financial services are observed among smaller firms, bottom 40 percent of the households (B40), unemployed/recipients of social transfers, women, rural, migrants, and youth. While access to traditional finance by firms is comparable to regional peers (World Bank Enterprise Survey 2019), access to traditional finance remains a challenge for many smaller firms. Limited use of digital financial services, especially payment products and services, can limit participation in the digital economy, given their critical role in enabling e-commerce and government-to-person (G2P) payments.

Usage of digital financial technology remains limited among smaller firms. Based on the 2019 World Bank Enterprise Survey, smaller formal firms (those with 5-19 employees) relied on more traditional methods of payment, especially cash, than electronic payments to make and receive payments (Figure 81). Paynet (2022) shows that while the use of cash remains substantial across geographic regions, there were relatively larger increases in the use of e-wallets for firms in the Northern and Central regions and increases in e-payments for firms in the East Coast.[61]

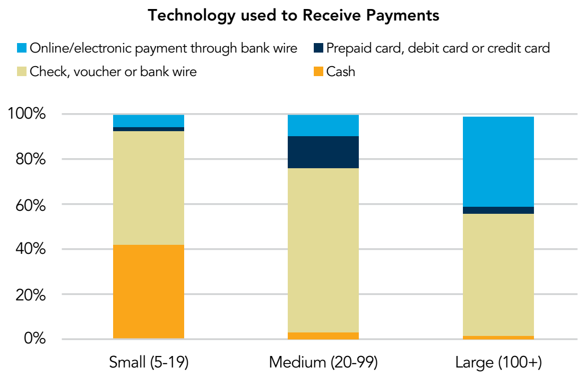
FIGURE 81

Smaller formal firms relied on more traditional methods of payment, especially cash.

Share of firms using technology to make and receive payments



Source: World Bank Enterprise Survey (2019)



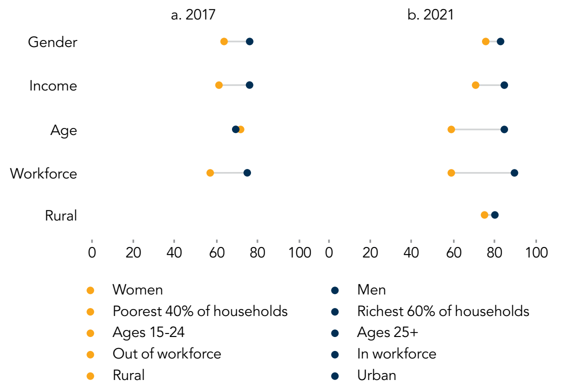
Source: World Bank Enterprise Survey (2019)

Vulnerable segments of the populations—including being part of the B40, female, and/or out of the labor force—remain unbanked, despite the expansion of digital financial services (Figure 82). For example, the B40 are more likely to be unbanked than richer adults, constraining their ability to transact formally in the digital economy. Lack of ID and someone in their family having an account are cited as the most common primary reasons for not having an account at a financial institution. There are also marked gaps for youth and the unemployed. Although the gender gap for digital payments has declined in 2021 vis-à-vis 2017, 16 percent of unbanked women in Malaysia cite lack of ID as their sole reason for not having an account, compared to 1 percent of unbanked men (World Bank, forthcoming).

FIGURE 82

Vulnerable segments of the populations remain unbanked, despite the expansion of digital financial services.

Adults in Malaysia who make or received digital payments, percentage



Source: World Bank Global Findex Database (2021)

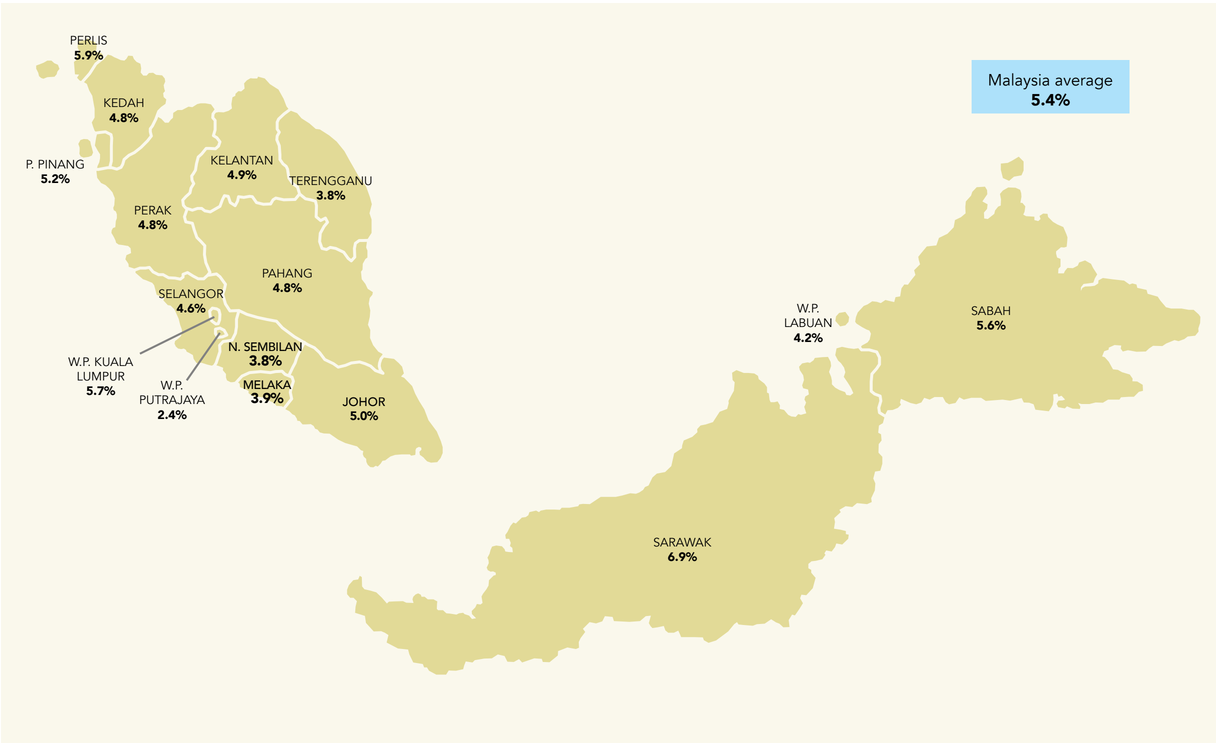
61 Paynet, 2022. "Digital Insights Study."

There are also geographic disparities among recipients of government social transfers. For one government cash transfer program *Bantuan Keluarga Malaysia* (BKM), targeted at Malaysians with incomes below RM5000 (US$ 1130) per month, Ministry of Finance data show that 445,485 of the 8.7 million beneficiaries in March 2022 were unbanked and received cash. The highest share of recipients receiving cash payments were in Sarawak (6.9 percent), Perlis (5.9 percent), Sabah (5.9 percent), which are three of the five states the World Bank (2022a) defined as "lagging" based on a measure of lowest average income/highest poverty rate (Figure 83).[62] However, surprisingly Kuala Lumpur which is wealthier also had 5.7 percent of recipients receiving cash, which is higher than the national average of 5.4 percent. World Bank Global Findex Data (2021) also indicate that Malaysia has a higher share of social transfer recipients receiving cash (6 percent) than its regional peer Thailand (2 percent).

FIGURE 83

Use of cash for social transfers can also vary by states.

Share of *Bantuan Keluarga Malaysia* recipients receiving payments in cash, percentage 2022



Source: World Bank staff analysis of Ministry of Finance data (November 2022)

62 World Bank. Catching Up Inclusive Recovery Growth for Lagging States Malaysia Economic Monitor June 2022

Constraints to adoption of digital technology remain

Despite digitalization being the most popular coping strategy during the pandemic, some constraints to more widespread usage of digital technologies remain. Connectivity challenges, lack of financial resources, lack of financial literacy, and lack of digital skills are commonly reasons cited as constraints to utilize digital technologies, particularly for SMEs and the B40.

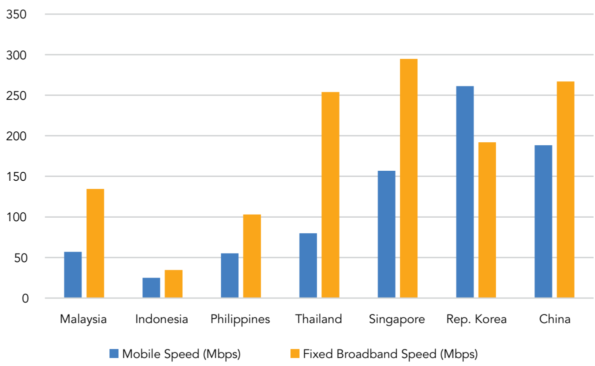
Challenge of Digital Connectivity

Relatively high access costs and slow connection speeds hinder deeper digitalization of the Malaysian economy. Although Malaysia has high internet penetration rates compared to regional peers, the speed of internet connections through mobile phones and fixed broadband is relatively slow (Figure 84), and the cost of connectivity as measured in the GSMA mobile connectivity index is relatively high (Figure 85), suggesting an important infrastructure gap. The EIU Inclusive Internet Index for 2022 also highlights affordability as a weakness for Malaysia, driven by the high mobile phone costs, mobile tariffs, and fixed-line broadband access as well as an insufficiently competitive digital environment.[63] The operability of cloud computing, internet of things, and usage of big data technologies depend on reliable service, capable of sustaining high volumes of information. Households and firms also need access to affordable, reliable, high quality and efficient networks, especially in the context of the pandemic to support remote working and e-learning for students.

FIGURE 84

The speed of internet connections is relatively slow relative to regional peers.

Internet connection speeds, Mbps

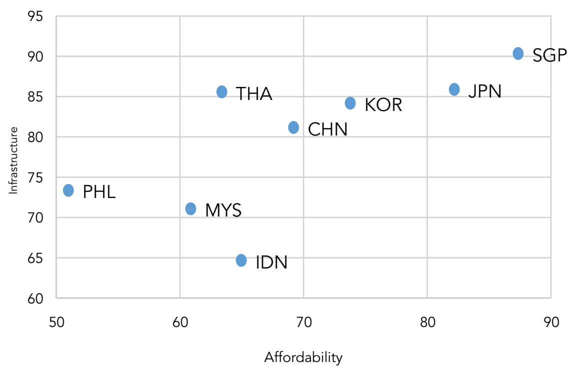


Source: Ookla's Speedtest Intelligence 2022

FIGURE 85

Cost of internet access is also relatively high.

GSMA mobile connectivity, index



Source: GSMA 2022

Lack of financial resources

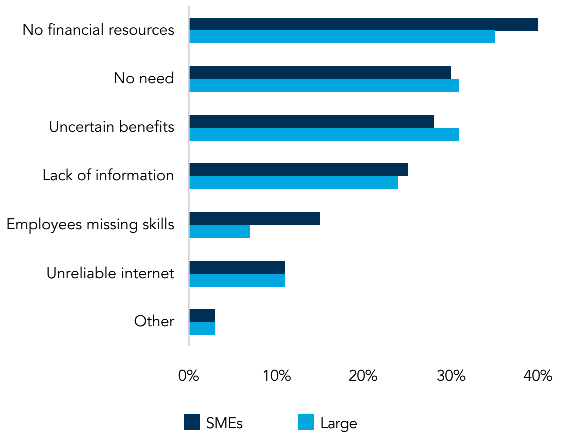
Limited financial resources were the top constraint cited by SMEs hindering a greater adoption of digital technologies, both before and during the pandemic. With digitalization being one of the most significant business coping strategies during the COVID-19 crisis, the top constraint to the adoption of new digital technologies reported by firms (excluding those that did not see a need to digitalize) was the lack of financial resources, especially for SMEs (Figure 86). This is largely consistent with pre-pandemic firm-level evidence, which revealed that the biggest barrier to digitalization by SMEs related to the perceived high costs and lack of awareness regarding financing options (Huawei and SME Corporation, 2018).

63 The Economist Impact, 2022. "The Internet Inclusive Index". https://impact.economist.com/projects/inclusive-internet-index/2022/country/Malaysia.

FIGURE 86

The top binding constraint to the adoption of new digital technologies was the lack of financial resources, especially for SMEs.

Reasons for not investing in digital solutions during COVID-19, share of firms, percentage

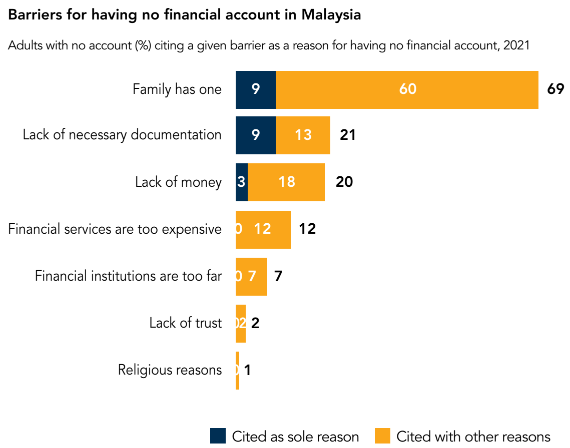


Source: BPS in World Bank (2022c)

FIGURE 87

Lack of funds or challenges in access to finance were cited as chief barriers for individuals not having an account in financial institutions.

Share of adults with no account citing a given barrier as a reason for having no financial account, 2021, percentage



Source: World Bank Global Findex Database (2021)
Note: Respondents could choose more than 1 choice.

Limited financial resources were also cited as a key reason for individuals being unbanked in Malaysia, along with the ability to share the account of a family member. The Findex 2021 survey shows that lack of funds or challenges in access to finance as a key barrier for not having an account in financial institutions (Figure 87). For example, 20 percent of the unbanked population in Malaysia cited the lack of funds, whereas 12 percent cited the high costs of financial services. Other frequently cited reasons were the ability to use the account of a family member (cited by almost 70 percent of the unbanked adults) and the lack of necessary documentation (21 percent). Importantly, unbanked individuals arguably face greater constraints in the usage of digital financial services. For instance, most users of mobile money accounts have an associated bank account. Hence, the lack of account ownership could in turn hinder the participation of the unbanked in the digital economy.

Lack of digital skills

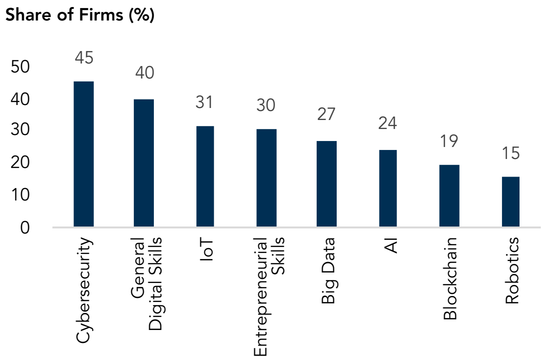
The BPS reveals that, after financial concerns, firms typically mention several factors constraining their usage of digital technologies that arguably reflect the lack of adequate skills. Specifically, firms cite the lack of need for digital services, lack of clarity regarding benefits of such services, and lack of information regarding relevant technologies as constraints. These results are also consistent with responses prior to the pandemic, in which SMEs highlighted inadequate employee skillset (IT, sales and marketing, business management); limited awareness of and/or access to digital technology; and lack of a digital business strategy and capacity to leverage digital technologies to transform business (Huawei and SME Corporation, 2018).

Skills are the constraint most cited by firms to further develop digital opportunities, with cybersecurity being a particular area of need. The BPS survey (February-March 2022) revealed that technical skills were the most cited by firms at 33 per cent of firms ahead of other factors as a constraint for firms to further develop digital opportunities. Cybersecurity, general digital skills and IoT are ranked as the most important missing skills within the firms surveyed. These types of skills are often outsourced (Figure 88).

FIGURE 88

Digital skills categories most outsourced due to lack of technical expertise…

Firms outsourcing types of digital skills, percentage

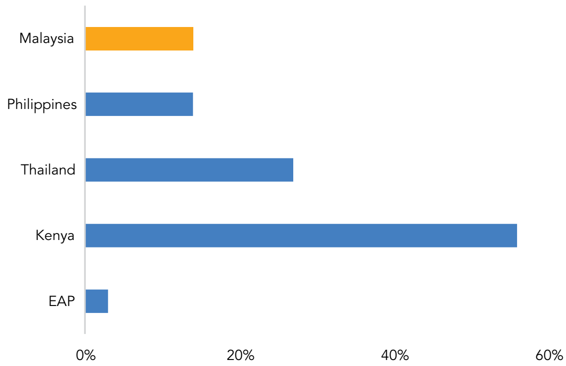


Source: World Bank, BPS

FIGURE 89

Only 14 percent of Malaysians report being able to use a mobile money account without help from anyone.

Need for assistance in using mobile money accounts, percentage



Source: World Bank Global Findex Database (2021)

Lack of basic digital literacy can also make it a challenge to use financial services, especially digital payments. On the firm side, a 2022 Paynet study found that the top reasons SMEs cited the lack of adoption of digital payments were related to the complexity of options and low awareness and education. Fees and charges were not part of the top 5 barriers to adoption of digital payments, and instead, on the top of SMEs' wish list were simpler onboarding processes and faster approvals. Similarly, for individuals, only 14 percent of Malaysians report being able to use a mobile money account without help from anyone, lower than in Thailand (27 percent) and Kenya, one of the world's leaders in mobile money (56 percent) (Figure 89). For unbanked individuals, just 24 percent reported that they would be able to use a bank account without help (World Bank Global Findex 2021).

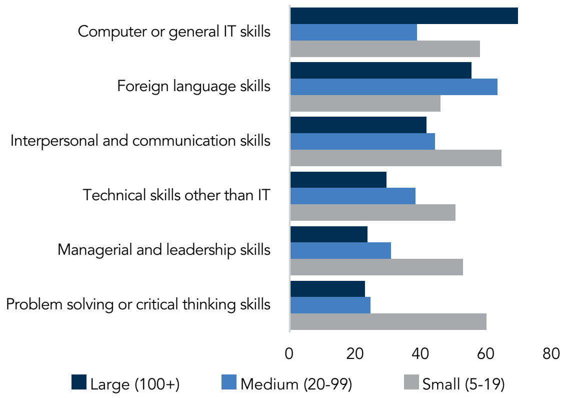
Difficulties meeting demand for advanced digital skills

The nature of jobs has been evolving in Malaysia, and employers reported difficulties finding employees with technical skills needed to take advantage of the benefits of digitalization, even before the pandemic. World Bank (2019) highlighted those skills related to digital technologies are increasingly in demand among employers in Malaysia.[64] Yet, IT skills (digital skills) are among the top 3 missing skills for employees in Malaysia. Based on World Bank Enterprise Survey data conducted in 2019, more than 50 percent of Malaysian employers faced challenges to hire employees for positions requiring three types of skills: i) interpersonal & communication skills, ii) foreign language skills and iii) computer or general IT skills. The challenge of finding employees with the digital skills affects the large firms more than SMEs—about 70 percent of large firms found it challenging to hire employees with computer or general IT skills, in comparison to about 58 percent for small firms (Figure 90).

FIGURE 90

For large firms, shortages in digital skills are the most pronounced.

Proportion of firms facing difficulties finding employees possessing the required skills, percentage



Source: World Bank Enterprise Survey (2019)

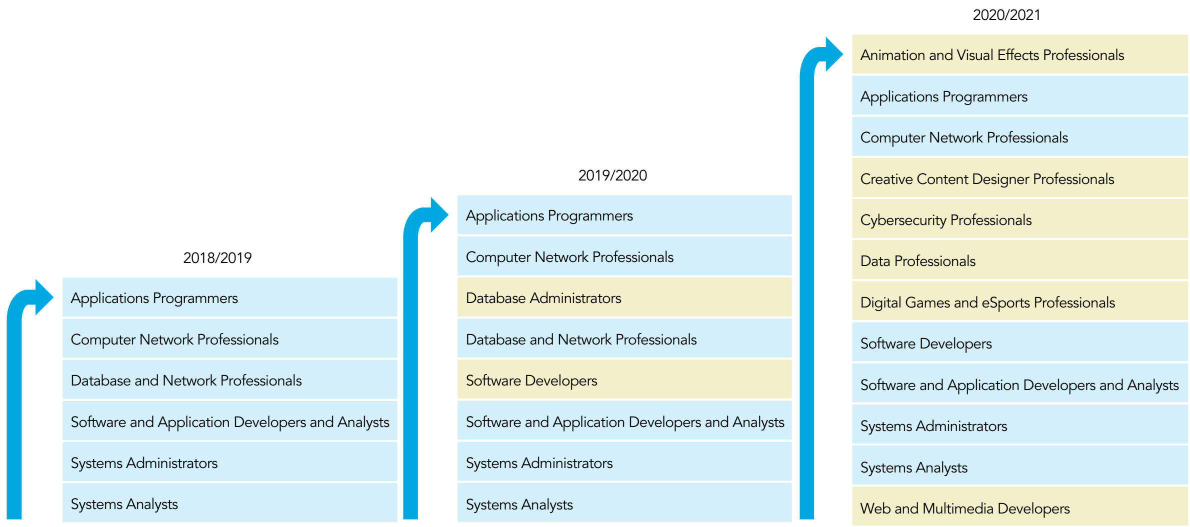
64 World Bank, 2019 "Aiming High: Navigating the Next Stage of Malaysia's Development."

Evidence from Malaysia's Critical Occupations List (COL) suggests that the demand for advanced digital skills have been increasing more rapidly than its supply.[65] Since 2018, a wider range of occupations requiring advanced digital skills have been added to the COL (Figure 91). For example, two such occupations were added in the 2019/2020 COL, and another five occupations were added to the 2020/2021 COL. Five of the six occupations requiring advanced digital skills that appeared in 2018/2019 COL have remained on the list for the six years that the COL has been produced, indicating a consistent lack of these skills. Furthermore, education requirements in job vacancies also fell (CSC 2021), which carries risks of adverse effects on productivity.

FIGURE 91

A wider range of occupations requiring advanced digital skills have been added to the critical occupations list.

Occupations requiring advanced digital skills on the COL



Source: Authors' elaboration based on CSC (2019, 2020, 2021)
Note: Occupations highlighted in yellow are those that are newly added to the COL each year.

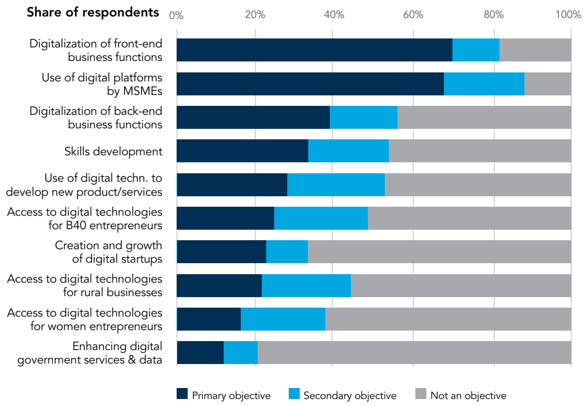
Government programs have supported firms to help digitalize front-end functions and back-end function but should prioritize filling skills gaps among prospective employees in Malaysia. Specifically, the 2021 World Bank SME digitalization support survey conducted among government agencies in Malaysia (World Bank, 2022c)—shows that the primary objective of most government support programs was to enable SMEs to digitalize front-end (i.e., customer-facing) business functions, such as sales and marketing, and to engage in e-commerce through participation in digital platforms (Figure 92). BPS survey data show that this corresponds with the most expressed needs by the businesses themselves (Figure 93), but going forward, there is scope to prioritize skills development among employees, which is currently ranked number four among most common government support programs, to address digital skills shortages (World Bank 2022c).

65 The COL, produced by the Critical Skills Monitoring Committee (CSC) led by TalentCorp and the Institute of Labor Market Information and Analysis (ILMIA), is Malaysia's occupational shortage list which focuses on identifying mid- and high-skilled occupations that are in demand and experiencing labor shortages.

FIGURE 92

Primary objective of most government support programs was to enable SMEs to digitalize front-end business functions…

Main objectives of SME digitalization programs, percentage

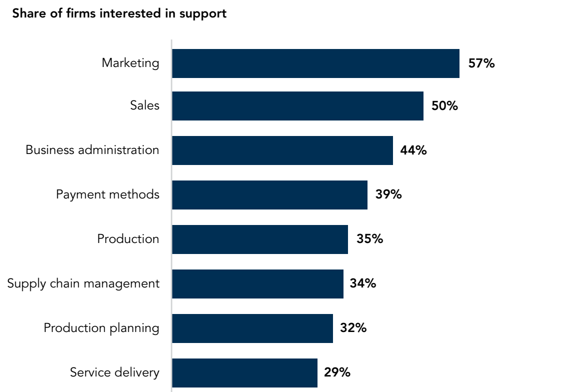


Source: World Bank (2022c)

FIGURE 93

…and this corresponds with the two most expressed needs by the businesses themselves.

Most needed areas for digitalization support



Source: BPS in World Bank (2022c)

Public sector employees also face skills gaps that can impede the goal of digital transformation of government, particularly in the analysis of data. The Malaysian government initiated several measures since 2015 on public sector big data analytics. They include developing circulars and guidelines on big data analytics for government agencies and establishing the National Big Data Analytics Center (NBDAC).[66] However, it is unclear to what extent line ministries and agencies have plans to use data to improve decision making and foster innovation in public service delivery. Box 8 describes international experiences supporting the broader digital government transformation and digital skills development for the public sector.

66 Public Sector Big Data Analytics, MyGovernment Portal https://www.malaysia.gov.my/portal/content/30617

BOX 8

Supporting the Digital Transformation of Government: International Experiences

The Government of Malaysia has launched ambitious programs on digital governance. As it advances in transforming the way the public sector operates and engages with citizens, effective international examples can provide insights on ways to achieve strong outcomes.

Upgrading the regulatory framework for citizen-centric digital services. Argentina has mandated the Once Only Principle by decree, requiring that its Public Administration request pertinent documentation once from the citizen, and no public body should require citizens to present documentation on paper. If citizens present a paper document, the receiving agency must digitize it. Government offices must exchange information through the Module "INTEROPER.AR" of the Electronic Document Management System.

Developing digital skills in the public sector. The experience of OECD countries in the European Digital Competence Framework (DigComp) describes the skills needed for the larger share of the global labor market. DigComp 2.1 has five competence areas – information and data literacy, communication and collaboration, digital content creation, safety and problem solving – and 21 specific competences. The United Kingdom has a Digital, Data, and Technology Profession Capability Framework, which describes specific jobs and the skills that are needed to do that job. The framework also describes the career pathways available in each role, from entry level to management or executive level and the corresponding skill level (awareness, working, practitioner, expert). Australia has developed a Digital Professional Stream to lift the digital expertise of the Australian Public Service workforce and meet long-term capability needs. A Building Digital Capability program has developed a career pathways framework with skill definitions for 150 digital roles. The pathways also show how individuals can transition to different or more advanced digital roles, providing a clear pathway for learning and development.

Leveraging opportunities to maximize the development dividends of digitalization

Malaysia can harness and leverage the opportunities brought on by the greater digitalization trend post-pandemic to narrow the digital divide and build an enabling ecosystem for the digital economy, thereby maximizing its development dividends. To tackle the main challenges documented in the previous sections, a set of policy recommendations would expand Malaysia's digital frontier.

The recommendations in this report prioritize five policy areas: (i) digital infrastructure, (ii) digital platforms, both private and public, (iii) digital payments as an entry point for digitalization of financial services, (iv) digital literacy, including advanced digital skills and digital financial literacy, and (v) digital safeguards. These policy priorities are designed to support a solid foundation for a dynamic, safe, and inclusive digital economy while mitigating key risks.

First policy priority area: Promoting the development of digital infrastructure, including through an enabling framework for competition. For consumers, increased access to digital infrastructure can lead to welfare gains, whereas for firms, it can boost competitiveness and lead to job creation. Effective competition can help to drive higher investment in networks for critical infrastructure and expands coverage that maximizes profits. Competition can be enhanced by ensuring licensing and regulatory rules support competition, constrain anti-competitive behavior and serve to reduce costs for operators, with recommended actions as follows. Specifically, to ensure the digital competition framework is sufficiently dynamic to meet the challenges of the rapidly evolving digital economy, Malaysia can:

i) **Amend the Competition Act 2010 to include a mandate to control anti-competitive effects of mergers and acquisitions.** Adding merger control powers in digital market controls would enable authorities to identify and address potential threats before a merger, rather than trying to respond to anti-competitive outcomes afterwards. The emergence of digital platforms can support business models that can incentivize aggressive expansion, vertical integration, and the exploitation of network effects. These changes mean traditional competition frameworks may no longer adequately tackle competition risks (World Bank, 2022c). Thus, traditional anti-trust tools need to be adapted to the specific features of digital markets.

ii) **Ease foreign entry restrictions, which may help boost investments in modern, high-quality, and affordable telecommunication services.** Allowing foreign entry has the potential to close some important gaps in the digital infrastructure in Malaysia. Specifically, it could improve the quality and speed of its telecommunications services, especially through fixed fibre broadband and in the next generation of communication networks to keep up with advancements in digital technology (World Bank, 2022b).

Second policy priority area: Catalysing private and public digital platforms by fostering open standards, interoperability and open data, complementing government adoption of digital technology with social accountability tools and user-centered digital services and enhancing logistics management and customs for e-commerce. The second set of policy priorities aim at establishing an enabling environment that supports the development of public and private digital platforms, which in turn, can drive the digital economy by increasing the availability of products and services through digital means. Moreover, well-developed government platforms can boost government efficiency and transparency and promote the development of private digital businesses. The recommendations to support the development of digital platforms include:

i) **Foster the usage of open standards, open interfaces and interoperability, and the framework for open data, including for cross-border transactions and government systems.**

- **Enhance the interoperability of standards and systems across countries.** Interoperability frameworks reduce system boundaries by setting common standards and guidelines across systems, thereby allowing a seamless exchange of information and communication. As cross-border e-commerce transactions grow in a rapidly expanding digital economy, there is a need to ensure interoperability between digital frameworks to facilitate these cross-border transactions (World Bank, 2022b and 2022c).[67] Online Dispute Resolution (ODR) mechanisms can facilitate cross-border dispute resolutions, such as the establishment of an ASEAN ODR Network. They can also improve consumer protection and further promote regional digital trade.

- **Improve the interoperability of government portals**. While Malaysia introduced the Malaysian Government Interoperability Framework or MyGiF in 2003, it has only been partially implemented since then. Nonetheless, the 2022 GTMI survey indicates that Malaysia has put in place an interoperability platform or "government service bus" (GSB). There is a need to review the framework to check if an update is required.[68] In social safety net programs, for example, Malaysia maintains several program-specific beneficiary lists and databases.[69] In social safety net programs, for example, Malaysia mantains several program-specific beneficiary lists and databases. The lack of interoperability limits the scope for referrals between and across programs, while also undermining the ability to identify double dipping. The issue is recognised by government, and efforts are underway to link such databases. For example, implementing an integrated social registry covering a substantial share of the population, as recommended in Malaysia Digital Economy Blueprint (EPU, 2021), would enable effective coordination and consolidation of programs. The ongoing assessment of the interoperability of existing administrative databases of cash transfer programs led by the Malaysia Social Protection Council is a starting point for the creation of an integrated social registry.

- **Support legal and regulatory reforms to advance the framework for open data to drive growth and innovation and improve citizen well-being.** Data are "open" if they can be freely used, re-used, and redistributed, including data sharing across different institutions, with the permission of the data subject. Open data can increase transparency, improve public service, stimulate economic opportunities, encourage innovation, lead to new business models and services which can encourage innovation.[70] Malaysia has fostered open data initiatives, though implementation remains at very early stages. For the public sector, Malaysian authorities adopted a General Circular on Open Data in 2015 (World Bank 2022c). However, there are several challenges which limits agency-wide adoption to this circular. A Khazanah Research Institute discussion paper on Open Government Data found that individual government agencies have broad autonomy in deciding what data can be shared.[71] This decentralized nature of data management across government and the absence of an overarching policy framework on open data means that the process of data sharing may not be streamlined, and the quality of data supplied could be uneven. For the financial sector, open data is a goal in Malaysia's 2022 Financial Sector Blueprint. Countries that have adopted open banking or open finance frameworks have diverse goals, such as enhancing competition in retail banking (United Kingdom), promoting innovation (Brazil), supporting inclusion (India), and enhancing financial planning (Singapore), which have guided their legal and regulatory reforms and their choice of governance framework.

ii) **Complement government adoption of digital technologies with the promotion of social accountability tools and user-centered digital services.** In Malaysia, citizens' engagement in the design of government digital solutions remains low, and institutional channels for citizens direct monitoring of the quality of digital services are limited. Without systematically tracking users' feedback, the relevance and utility of

67 Povera, A and Krishnan, D.B. "New online dispute resolution mechanism for SMEs soon, says PM", New Straits Times, September 6, 2022.

68 Ashraf Shaharudin. 2020. Open Government Data in Malaysia: Landscape, Challenges and Aspirations. Kuala Lumpur: Khazanah Research Institute.

69 The three social assistance registries in Malaysia: eKasih (administered by the Implementation and Coordination Unit in the Prime Minister's Department), eBantuan (administered by the Ministry of Women, Family and Community Development), and the registry for Bantuan Keluarga Malaysia. Social assistance programs administered by other agencies or ministries may partially rely on eKasih but are also likely to conduct their own outreach activities using a combination of in-person and digital/online mechanisms.

70 See for example http://opendatatoolkit.worldbank.org/en/starting.html.

71 Ashraf Shaharudin. 2020. Open Government Data in Malaysia: Landscape, Challenges and Aspirations. Kuala Lumpur: Khazanah Research Institute.

digital solutions remain an open question. For example, recent research found that around 200 smartphone apps have been developed across 93 government agencies. About half of those apps have been downloaded less than 1000 times, suggesting their limited utility to address citizens' needs.[72] Citizen scorecards and social audits allow citizens to publicly evaluate the quality, adequacy, and efficiency of government public services. ICT-enabled solutions, such as citizen voice platforms, should also be encouraged, taking advantage of mobile-phone diffusion and the rapid increase of social media users. Advanced technology (e.g., chatbots or AI-enabled discussion forums) could improve citizen engagement that is almost absent in the MyGovernment portal. Indicators to systematically track the quality of services delivered could be gathered through customer satisfaction surveys. However, a fundamental shift toward user-centric service delivery has yet to take place in Malaysia, and government systematic efforts to collaborate with citizens when designing and evaluating digital services are still limited. This slow progress reflects broader governance[73] challenges in Malaysia and low levels of citizens engagement relative to comparator countries.

iii) **Strengthen Malaysia's logistics management and customs to improve cross-border trade competitiveness, especially e-commerce.** Malaysia's logistics performance ranks relatively low internationally, at 41st place out of 160 countries based on World Bank's Logistics Performance Index. Last mile delivery is a challenge, with stakeholders revealing the problem is more acute within East Malaysia relative to Peninsular Malaysia (World Bank, 2022c). A fully integrated e-customs system with end-to-end functions would be instrumental to improve transparency and allow users to track their processes and status of deliveries. By improving logistics through digitalization of government custom processes, Malaysia can benefit from improvements in its trade competitiveness (World Bank, 2020).

Third policy priority area: Fostering digital payments as an entry point for digitalization. Greater efforts can be placed on digitalizing common cash payments in Malaysia to foster more widespread inclusion into the digital economy and lower transaction costs for payment transactions. Specific suggested recommendations include:

- **Transition adults and firms who are still making or receiving common payments in cash to digital payments.** For example, 2021 World Bank Global Findex data shows Malaysians transacting regularly in cash: 36 percent of those paying utilities, 14 percent of those with remittances, 13 percent of online shoppers paying cash on delivery, and 10 percent of wage recipients and 6 percent of government transfer recipients receiving cash only. New e-remittance registrations in Kota Kinabalu in 2018-2019 were associated with a reduction in remittance costs to migrant workers from 4.5 to 2.2 percent in 22 months (World Bank Greenback 2.0 Report 2020). Similarly, shifting government payments from cash to transaction accounts can reduce costs and support. In Thailand, universal digital ID, a sophisticated and interoperable digital platform, and several administrative databases to filter eligibility helped transform its modest cash transfer programs to one of the world's largest responses to COVID-19. To encourage firms to transition to digital payments, governments in Uruguay and Korea used tax incentives to encourage businesses and individuals to adopt digital payments. Value-added services, such as bookkeeping and tax filing, can also improve prospects for digital credit.

- **Consider additional mechanisms to incentivize e-wallet usage.** Exchanging money from electronic value to cash from a Malaysian e-wallet or vice-versa entails additional processes including detailed verification of customers, which could result in limited offerings of such options (beyond cash withdrawal at ATMs and cash reload at selected merchants), including service through agents. International experiences suggest that digital transaction volumes increase when there are simple procedures and multiple options to fund and retrieve funds from e-wallets. Payments platforms in China catalysed account ownership, particularly in rural areas, through agents in administrative villages. In Thailand, cash-in and cash out is enabled through retail partners and ATMs. Lastly, in Indonesia, during COVID-19, 87

72 Free Malaysia Today, "Get rid of 'useless' apps, DAP MP tells govt", September 12, 2022. https://www.freemalaysiatoday.com/category/nation/2022/09/12/get-rid-of-useless-apps-dap-mp-tells-govt/

73 Governance is defined as "the process through which state and nonstate actors interact to design and implement policies within a given set of formal and informal rules that shape and are shaped by power" (World Development Report Governance and the Law, 2017, World Bank).

percent of government social assistance recipients preferred e-wallet payments due to convenience.[74]

- **Enhance the availability and usage of alternative data, especially for the financial sector, to improve the risk analysis and the development of customized financial products and services.** Promoting the development and sharing of alternative data—for example, transaction data from telecommunication and utility companies—can support financial institutions in extending services to more consumers. Data generated from digital transactions and payments can be used to build credit history for underserved consumers and firms and can help overcome challenges associated with informality, lack of documentation, and lack of financial information in the traditional credit information system (CCRIS). These data can also be used to customize products and services to client needs.

Fourth policy priority area: Supporting initiatives to develop digital literacy, focusing on targeted interventions, appropriate public support to develop workforce skills needed for digitalization, and digital financial literacy to address gaps in capabilities. Digital literacy is critical for workers to benefit from the new job opportunities created by the digital economy and the general population to use and benefit from digital products and services.

i) **Target digital literacy training to specific groups such as youth and those in 'last mile' areas in order to narrow the skills gap.** While the government showed the importance of advancing digital skills through the introduction of the Digital Education Strategy, the absence of basic technologies, such as affordable internet connectivity hampers the development of digital skills in "last-mile" remote areas. Better targeting of relevant training is warranted, and teaching of digital literacy (along with other in-demand skills like socio-emotional learning) should begin in the early years of education. In addition, deeper study of the effectiveness of such training, and the measuring of digital skills among the students once they enter the workforce, would be useful to guide future policies.

ii) **Improve the accessibility and relevance of public support to develop workforce skills.** This would include both programs supporting skills necessary for SME digitalization and government collaboration with universities to integrate digitalization into their curriculum. At universities, digital skills could be taught to students in traditional academic disciplines, for example, accounting and human resource management, could be trained for Electronic Resource Planning (World Bank 2022c). In addition, to address shortages in workers with digital skills, retraining programs for the existing workforce could be developed. Overall, these priorities would entail giving more weight to a skill-based certification in the hiring and rewards system of companies and ensuring that in-demand digital skills are regularly updated (Dondi. M. et. al, 2021).

iii) **Foster investments in digital skill development for the public sector to help maximize the benefits of the GovTech transformation.** In 2021, with the Malaysia Digital Economy Blueprint launch, the government announced plans to expand digital training for public servants across all grades and schemes. The Digital Government Competency and Capability Readiness Framework (DGCCR)[75] has been developed and training programs on digital competencies for public sector employees began in 2019. Allocation of sufficient budget and monitoring of results indicators focused on digital skill building are needed.

iv) **Support greater digital financial literacy through targeted interventions.** In addition to knowledge of products and services, consumers need greater awareness of digital financial risks like online fraud, digital footprint, and overborrowing. International experience suggests that partnering with institutions targeting segments of the population with lower use of digital and conventional financial services can be effective in fostering inclusion and financial education. Appropriate partners differ by segment (e.g., ministries and social programs for B40 and unemployed, schools for youth, embassies, and employers for migrants etc.). The delivery of capacity building efforts should be targeted according to challenges and location of vulnerable groups.

Fifth policy priority area: Managing and mitigating the main risks associated with the digital economy's growth with digital safeguards, including enhanced data privacy, consumer protection and cybersecurity.

74 Azzani et. al. Driving Inclusion and Resilience Through Multi-Channel Government-To-Person Payment: Lessons Learned From Indonesia's Kartu Prakerja (2022).

75 Digital Government Competency Capability and Readiness https://docs.jpa.gov.my/docs/flipbook/DGCCR-Sektor-Awam/

The transformation of Malaysia's economy towards greater digitalization is not without risks. Specifically, strong safeguards are needed to manage and mitigate the main risks associated with the digital economy's growth. As highlighted in the World Development Report 2021, appropriate government regulations are critical to promote trust in the digital economy, thereby making citizens and businesses more willing to adopt digital solutions. These include privacy protection (especially regarding data), consumer protection, and cybersecurity (including defending information and infrastructure from cyberattacks).[76] Hence, the main policy recommendations in this area pertain to the legal and regulatory frameworks needed to confront these risks include the following:

i) **Build strong systems for digital identification and authentication.** Central to digital transactions is the ability of service providers to accurately identify and verify customers without physical interactions. For example, digital IDs allow for secure remote identification and authentication of a person's identity, enabling access to online and mobile digital financial services. Digital ID systems more broadly may help financial institutions comply with customer due diligence (CDD) requirements, which aim to prevent criminal activity such as fraud and money laundering which have been highlighted as challenges in Malaysia. A National Digital ID Initiative is under development in Malaysia, and Malaysia's e-KYC (electronic-Know-your Customer) regulations, issued for individuals in 2020, are under consideration to be expanded to include e-KYC for businesses (eKYB).

ii) **Expand the legal and regulatory framework for data privacy protection, including and going beyond the 2020 proposed amendments to the 2010 Personal Data Protection Act (PDPA).** Challenges in Malaysia's data protection framework represent risks for digitalization of services and challenges to further uptake. The current 2010 PDPA does not have strict requirement on both encryption and anonymization of personal data (World Bank, 2022c). The 2020 public consultation paper[77] included proposed changes such as requiring all data users to appoint a data protection officer, introducing data breach notification, and allowing the transfer of personal data (data portability) which would bring Malaysia's laws closer to international good practices, such as the European Union's General Data Protection Regulation (GDPR) and the OECD Privacy Framework. However, even if these amendments were enacted in their entirety, substantial gaps in data protection would remain. Clause 3 of the 2010 PDPA notes that it does not apply to the Federal Government and State Governments, leaving a gap in the event of a government data breach.[78] And the proposed amendments would not make data portability compulsory if data users state that they do not have a sufficient technical system to share data (World Bank, 2022c). Mandating application programming interfaces (APIs) would then play an important role to ensure data portability occurs.

iii) **Strengthen Malaysia's framework for consumer protection for digital financial services, through enactment of the 2022 Consumer Credit Act proposal, development of a single window to receive financial consumer complaints and more user-friendly redress mechanisms.**

- **Enactment of the 2022 Consumer Credit Act proposal.**[79] This would help build trust in the credit ecosystem by creating a framework for regulating non-bank entities providing credit services, including the rapidly growing "Buy Now, Pay Later" products that are fully operated on digital platforms. It would also establish a framework to deter abusive lending practices and a Consumer Credit Oversight Board to function as a digital-based regulator.
- **Consider a single window for financial consumer complaints.** Due to the current fragmentation of categories of consumer complaints under different government agencies, it is complex to know where to direct

76 World Bank, 2021b. World Development Report 2021: Data for Better Lives. Washington, DC: World Bank. https://www.worldbank.org/en/publication/wdr2021

77 Personal Data Protection Department. 2020. KKMM. Review of Personal Data Protection Act 2010. https://www.pdp.gov.my/jpdpv2/assets/2020/02/Public-Consultation-Paper-on-Review-of-Act-709_V4.pdf

78 Laws of Malaysia Act 709. Personal Data Protection Act 2010. https://www.pdp.gov.my/jpdpv2/assets/2019/09/Personal-Data-Protection-Act-2010.pdf

79 Consumer Credit Consumer Credit Oversight Taskforce. Public Consultation Paper. August 4, 2022.

complaints. For example, for digital financial services, institutions include: (i) Royal Malaysia Police (property fraud/money), (ii) Ministry of Domestic Trade and Cost of Living (fraudulent purchases), (iii) BNM (scams and illegal deposit taking) and (iv) Malaysian Communications and Multimedia Commission (MCMC) (digital economy transactions).[80] Requirements to file a police report can also be challenging, given the limited capacity to process reports on non-urgent crime.[81]

- **Allowing more alternative dispute resolution (ADR) mechanisms** would be more accessible/user-friendly than going to court. Furthermore, financial consumers who are victims of data breaches or financial frauds are required to go to court in many cases to seek redress, which is a substantial barrier to many. While the Ombudsman of Financial Services (OFS) addresses disputes between customers and FSPs for unauthorized transactions,[82] current laws do not empower the police to help fraud victims recover their lost money from the perpetrator (see Box 9: Mitigating Fraud in Digital Financial Services – International Experiences).

80 Malaysian Communications and Multimedia Commission. What are the steps required for me to lodge complaint regarding content in the Internet? https://www.mcmc.gov.my/en/faqs/online-content-problems/what-are-the-steps-required-for-me-to-lodge-compla

81 From 2019 to July 2022, a total of 63,723 financial fraud cases were reported to PDRM. Crime suspects were detained for 52 percent of the cases and 67 percent of them have been brought to court during the period.

82 The Ombudsman of Financial Services (OFS) addresses disputes between customers and FSPs related to unauthorized transactions through designated payment instruments below RM25,000 and banking and payment systems products below RM250,000.

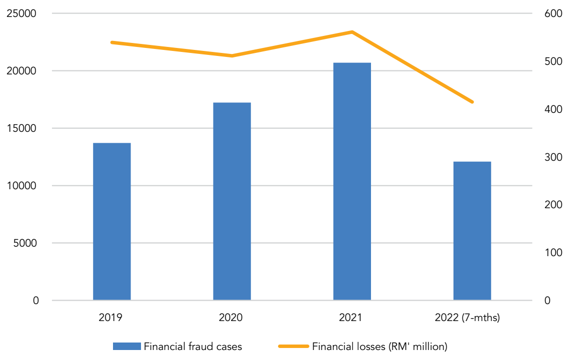
BOX 9

Mitigating Fraud in Digital Financial Services - International Experiences

Financial consumers already faced a range of fraud risks prior to COVID-19, but the incidence of fraud and scams in Malaysia continued to increase significantly during the pandemic. Globally, a 2022 World Bank-CCAF Global Fintech Regulator Survey of 128 financial authorities reports that 67 percent of respondents perceive fraud and scams as a top risk for consumers, up from 18 percent in 2020.[83] In Malaysia, a survey found online fraud increased from 17.7 percent to 23.6 percent from 2016 to 2020,[84] and reported financial fraud cases grew an average 20 percent annually from 2019 to 2021 (Figure 94) with losses totaling RM1.6 billion.[85] In 2022, iPay88, one of the largest online payment providers in Malaysia, experienced a cybersecurity breach of cardholder data, requiring BNM, as regulator to impose further supervisory measures.[86]

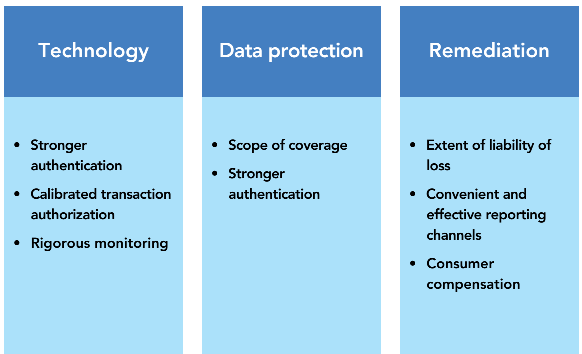
FIGURE 94
Financial fraud cases are on the rise in Malaysia.

Number of reported financial fraud cases and estimated losses (RM million)



Source: WB analysis of Royal Malaysian Police data (2022)

FIGURE 95
Summary of gaps, fraud mitigation and remediation.



Source: Authors' elaboration World Bank

Malaysian authorities and regulators have been trying to combat financial fraud (Figure 95). BNM, the police enforcement agency (PDRM), Malaysian Communications and Multimedia Commission (MCMC) and the financial industry collaborated to increase fraud awareness, recover embezzled funds and promote effective investigations by law enforcement.[87]

In 2022, BNM announced countermeasures for the National Scam Response Centre (NSRC), including improvements in authentication and fraud detection, cooling off-periods for first-time enrolment in online banking and hotlines to report financial scams. Table 4 shows several international examples of ways other jurisdictions have tried to prevent and address fraud.

83 World Bank and CCAF (2022) The 3rd Global Fintech Regulator Survey, World Bank Group, and the University of Cambridge.

84 Internet Users Survey 2020 by Malaysian Communications and Multimedia Commission (MCMC).

85 Basyir, M and Harun, H.N. (2022, September 26), "Online scam cases increasing in Malaysia". New Straits Times https://www.nst.com.my/news/nation/2022/09/834531/online-scam-cases-increasing-malaysia

86 Bank Negara Malaysia (BNM) (2022, October 7), "BNM Instructs iPay88 to Further Strengthen Cyber Security Controls". https://www.bnm.gov.my/-/ipay88-to-further-strengthen-cyber-security-controls.

87 BNM (2022, June 9), "BNM steps up collaboration with banks and law enforcement agencies to combat new modus operandi by financial fraudsters". https://www.bnm.gov.my/-/combating-financial-fraud.

TABLE 4
International regulatory approaches to fraud mitigation and remediation

Authentication technology	The **European Union's** Payment Services Directive 2 (PSD2) provides security requirements for the initiation and processing of electronic payments, requiring appliance of 'strong customer authentication'
Transaction authorization technology	**Brazil:** Financial Service Providers and Payment System Providers should identify which transactions may be higher risk from fraud or scam. The Central Bank of Brazil (CBB) has a low cap on all electronic transactions and requires PSPs to monitor electronic payment transactions they initiate.
Data protection	**European Union's** General Data Protection Regulation (GDPR) sets a series of requirements on accountability and data security. Fines could reach €20 million or 4 percent of global revenue of the sanctioned company, plus compensation for damages.
Data and information sharing	**Brazil: Increase sharing of good practices with peers to convey the agenda of fraud prevention.** CBB disseminates benchmark fraud prevention tactics with the Brazilian Banks Federation, and government authorities are urged to coordinate across agencies given the diversity of mandates.
Digital Literacy	**Global:** Increase in awareness campaigns targeted at more susceptible consumers using traditional and social media.
Remediation (dealing with unauthorized transactions)	**Consumer assistance should be provided to reverse or limit the financial loss, as well as allocate the risk of loss appropriately.** Measures include: • **Australia:** Clarity on consumer's obligations and extent of liability for loss. The Australian Securities and Investments Commission (ASIC) ePayments Code details preventive mechanisms and liability criteria and requires PSPs to have easy, free ways to report unauthorized transactions. • **Europe and Australia:** Timely investigation and resolution mechanisms to compensate consumers – PSD2 sets a liability cap of up to €50 in cases not involving negligence, while ASIC adjusts PSP liability to actions. • **Brazil:** Identification of accounts that receive fraudulent assets and steps to limit opening of fraudulent accounts. CBB requires PSPs in its PIX instant payment platform to improve flagging of suspicious accounts and seizure of diverted assets.

Source: World Bank staff interpretations

iv) **Reduce fragmentation in the legal framework for cybersecurity to strengthen Malaysia's resilience to cyberthreats** (World Bank 2022c). Current laws in Malaysia dealing with cybercrimes are fragmented across different legislations including the Computer Crimes Act 1997 (CCA 1997) and the Communications and Multimedia Act 1998 (CMA 1998). They are also fragmented across different enforcement agencies, which can hinder efficient enforcement efforts. An overarching Cyber Security Law, which is currently being considered under the Malaysia Cyber Security Strategy 2020-2024, could help strengthen coordination and efficiency.

TABLE 5
Summary of key policy recommendations

Priority area	Policy recommendations
1. Digital infrastructure	**Catalyze private sector investments in infrastructure by strengthening the framework for competition:** i. Amend the Competition Act 2010 to include merger control powers (MT) ii. Ease foreign entry restrictions in telecommunications and network services (MT)
2. Digital platforms (public and private digital businesses)	**Catalyze platforms that support business growth and public efficiency:** i. Foster the usage of open standards, open interfaces, and interoperability of digital systems, including for cross-border transactions and government portals, and advance the framework for open data (MT). ii. Complement government adoption of digital technology with social accountability tools and user-centered digital services (MT) iii. Improve Malaysia's logistics management and customs, especially for e-commerce (ex: e-customs system) (MT)
3. Digital Financial Services	**Foster digital payments as a key entry point for digital financial services:** i. Transition adults and firms making or receiving payments in cash to digital payments as an entry point to digital financial services and the digital economy (MT). ii. Consider additional mechanisms to incentivize e-wallet usage (ST). iii. Enhance the use of alternative data to support enhanced decisions by industry (MT)
4. Digital literacy and advanced digital skills	**Enhance digital skills to support a more efficient and effective private and public sector:** i. Target digital literacy training to the "last mile" areas and youth to narrow the skills gap (ST) ii. Improve accessibility and relevance of public support to develop digital skills for the workforce (ST). iii. Support greater digital financial literacy through targeted interventions (ST). iv. Foster investments in digital skills across the public sector to maximize the benefits of GovTech transformation (MT).
5. Digital safeguards	**Mitigate some of the main risks to the digital economy:** i. Build strong systems for digital identification and authentication, including eKYC and eKYB (ST) ii. Strengthen the legal and regulatory framework for data privacy, including going beyond the proposed amendments to the 2010 Personal Data Protection Act (PDPA) (ST). iii. Strengthen consumer protection for digital financial services: through enactment of the Consumer Credit Act proposal (2022), a single window for consumer complaints. and increased use of alternative dispute mechanisms (MT). iv. Reduce fragmentation in legal framework for cybersecurity (MT)

Source: World Bank staff interpretations
Note: ST=short-term, MT=medium-term

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