MALAYSIA ECONOMIC MONITOR

Sowing the Seeds

DECEMBER 2020

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Summary

The COVID-19 pandemic has exacted a heavy toll on Malaysia's economy

In 2020, the country experienced its sharpest recession in twenty years due to the impact of a triple shock related to the direct health impact of the pandemic; the economic impact of domestic restrictions on movement; and the impact of a synchronized global recession on Malaysia's tradeable sectors.

Malaysia's economy is projected to grow by 6.7 percent in 2021, after contracting by 5.8 percent in 2020. However, the rebound in economic activity is subject to numerous uncertainties such as the deployment of an effective vaccine and the robustness of a rebound in global growth. Notwithstanding a growth rebound in 2021, Malaysia is not expected to recover fully from the shock of COVID-19 within the next few years.

The Malaysian government has delivered a series of economic response packages to mitigate the impact of the crisis. Public policies, including cash transfers, wage subsidies and loan moratoria, have helped reduce the impact of the pandemic on vulnerable households and firms.

The rebound in economic activity is subject to numerous uncertainties such as the deployment of an effective vaccine and the robustness of a recovery in global growth

While these measures have been vitally necessary, they have been implemented at a time when the government is experiencing a dramatic decline in revenues, creating a challenge to the medium-term fiscal outlook. Like governments across the world, Malaysia has depleted much of its available fiscal space and will exit the crisis with a larger burden of debt and contingent liabilities. This has resulted in difficult intertemporal constraints for the government to

further expand expenditures on relief measures and consumption-supporting stimulus today, which may leave the government less equipped to invest in lasting recovery and growth tomorrow without the support of a stronger revenue base.

When the current situation stabilizes and recovery becomes more entrenched, the government should refocus its fiscal policy to rebuild buffers against future shocks and to sustain public financing for inclusive, long-term growth. Addressing the fiscal legacies of the present crisis and the pre-existing structural weaknesses constraining the government's ability to counter economic shocks and sustainably finance shared prosperity will require comprehensive medium-term plans to enhance revenue mobilization.

Looking to the future, to seize new growth opportunities and to overcome potentially long-lasting challenges brought on by the COVID-19 crisis, the government will need to consider bold structural reforms intended to ensure more durable, inclusive growth in a post-pandemic environment. Beyond its short-term consequences, the unique nature of the pandemic and its exceptional severity are also likely to have profound effects on long-term growth prospects. These effects may arise from various interlinked factors that will exacerbate the demand and supply shocks that the economy is facing.

The Malaysia Economic Monitor (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.

In this edition, the focus of the special topic is on Malaysia's food and agricultural sector and the role it can play in supporting a resilient recovery and future growth. The COVID-19 crisis has drawn attention to the food system and the continued relevance of food security as well as the need for food policy to focus on a wider range of risks and opportunities.

With Malaysia on the cusp of achieving high-income status, its current policy orientations have left it with a two-speed agricultural economy. By modernizing and diversifying its agrofood sector and better integrating it with its more dynamic "farm-to-fork" food economy, Malaysia could help advance other national priorities.

The structure and performance of these sectors have broad relevance to Malaysia's achievement of higher levels of inclusion, resilience, competitiveness, jobs growth, long-term economic growth, and sustainability. With the writing of the 12th Malaysia Plan and the rewriting of food security policy at hand, Malaysia faces at least two immediate opportunities to lay out a higher vision for its agrofood sector and adopt a befitting set of policies.

PART ONE

Recent Economic Developments and Outlook

Recent economic developments

In the third quarter, with the easing of pandemic-related movement restrictions following the implementation of the Recovery Movement Control Order (RMCO), Malaysia's economy continued to contract, albeit at a much lower rate than in the previous quarter, at -2.7 percent (Q2 2020: -17.1 percent). The improvement in economic activity was broad-based across all sectors, led by the manufacturing sector which recorded a positive growth of 3.3 percent during the quarter (Q2 2020: -18.3 percent). Services, construction and mining sectors recorded smaller declines as movement restrictions were relaxed. The agriculture sector posted a small decline of 0.7 percent (Q2 2020: 1.0 percent), following slower growth of fishing, forestry and logging, rubber and the oil palm segments, which offset the gains recorded in the aquaculture and livestock segments.

Domestic demand also improved following the transition to the RMCO. Private consumption recovered to a considerable degree, with a much smaller contraction of 2.1 percent during Q3 2020 from -18.5 percent in Q2 2020. Various income support measures such as the *Bantuan Prihatin Nasional* cash transfers, wage subsidies and the *i-Lestari* Employees Provident Fund withdrawals boosted household spending during the quarter. Meanwhile, growth in public consumption rose from 2.3 percent in Q2 2020 to 6.9 percent in Q3 2020 from higher spending in supplies and services, and in emoluments.

Over this period, while aggregate investments continued to contract, the rate of contraction declined. Gross fixed capital formation contracted 11.6 percent in Q3 2020 (Q2 2020: -28.9 percent). The lower contraction in investments were driven by resumption in both private and public investments.

A number of other selected indicators suggest that there has been a gradual pick-up in economic activity. These include the manufacturing PMI and industrial production index for the manufacturing cluster which have been on an upward trend since April. Nevertheless, the recent re-imposition of CMCO following a surge in the number of new COVID-19 cases could dampen the pace of recovery in the near term.

Headline inflation remained negative in recent months. Headline inflation stood at -1.4 percent during Q3 2020 (Q2 2020: -2.6 percent) driven by lower transportation costs as retail fuel prices remained below their levels last year. Core inflation moderated slightly to 1.0 percent (Q2 2020: 1.2 percent) due mainly to lower rental and accommodation prices.

Malaysia is currently experiencing a third wave of COVID-19 infections. After successfully managing the pandemic and bringing the number of daily cases to single digits in July, there has been a

surge in infections since mid-September, with the number of new cases hovering between 1,000 and 2,000 at the national level.

Following the emergence of this third wave, the government re-introduced a stricter CMCO in most parts of the country. As a result, mobility in public places, including commercial spaces, has been restricted. Despite the imposition of these restrictions, the number of daily cases remain elevated. Both the resurgence of COVID-19 infections and containment efforts have dampened Malaysia's near-term economic recovery.

Malaysia's exports improved over the quarter, largely due to improved external demand. Gross exports expanded at the rate of 4.4 percent (Q2 2020: -15.1 percent), with the increase in the exports of manufactured and agriculture goods driving this recovery. The increase in manufactured exports was due to a rebound in E&E exports, especially to major trading partners such as China and the US; by firms fulfilling a large backlog of orders; and by an increase in the demand for work-from-home appliances, servers and medical devices. Over the same period, the contraction in gross imports eased (Q3 2020: -6.3 percent vs. Q2 2020: -15.1 percent) mainly due to the decelerating contraction in intermediate imports. The current account surplus increased considerably, from 2.5 percent of GDP in Q2 2020 to 7.1 percent in Q3 2020, due to higher goods surplus and secondary income balance. The conclusion of RCEP negotiations in November 2020, which will lead to the formation of the world's largest preferential trade area, is expected to be supportive of Malaysia's exports in the years ahead.

With the gradual re-opening of the economy, the unemployment rate has declined slightly from its peak of 5.1 percent in Q2 2020 to 4.7 percent in Q3 2020. At the same time, the implementation of movement restrictions since Q1 2020 has contributed to relatively high skills- and time-related underemployment rates.

The financial sector has remained resilient. The Central Bank of Malaysia (BNM) kept the Overnight Policy Rate (OPR) at 1.75 percent since July 2020. Despite pressure on earnings, banks maintained healthy capital and liquidity positions throughout H1 2020. The deferment of all loan and financing repayments has given businesses and households breathing space, although impairment ratios edged upwards to 1.43 percent overall in October 2020, albeit from historically low levels, driven by the household segment. These rates are expected to increase once the moratorium period ends.

The fiscal deficit is expected to widen to 6.0 percent of GDP in 2020 due to the economic downturn and the government stimulus measures. The fiscal deficit for 2020, initially projected in the Budget 2020 to stand at 3.2 percent of GDP, is now expected to widen to 6 percent of GDP (RM86.5 billion), compared to 3.4 percent in 2019. Expenditure is expected to increase by 3.4 percent of GDP, while revenue is expected to increase only by 0.6 percent of GDP, resulting in a 2.8 percent increase in the fiscal deficit.

The wider fiscal deficit resulted in a rise in federal government debt. Following the increase in government borrowing, government debt had risen to 60.7 percent of GDP by the end of September

2020. In order to expand fiscal space in response to the crisis, parliament passed the Temporary Measures for Reducing the Impact of COVID-19 Act 2020, which allows the government to temporarily raise the statutory limit on government debt from 55 percent GDP until 2023. The Act sets the domestic debt limit at 60 percent of GDP and at the end of September it stood at 56.6 percent of GDP. Federal government borrowings have continued to be mostly ringgit-denominated with a wide range of maturities, limiting exposure to exchange rate and rollover risks.

The budget includes various measures that would enhance social protection for vulnerable groups

Budget 2021 aims to provide support to lives and livelihoods, and introduces various measures to facilitate an economic recovery. The budget includes various measures that would enhance social protection for vulnerable groups by increasing the benefit level and expanding the beneficiary coverage of cash transfer programs. And to support economic recovery, the budget introduces new measures for upskilling and reskilling, with particular emphasis on specific groups of workers including the youth, the long-term unemployed, the disable and those who have lost their jobs during the crisis.

While the government is expecting a nominal increase in revenue collection in 2021; in proportion to GDP, revenue is projected to continue to decline. Federal government revenue is expected to decline further to 15.1 percent of GDP in 2021, almost one-third lower than its level in 2009 and well below the averages for upper-middle-income and high-income countries. Malaysia's declining trend in revenue collection will increasingly constrain the government's ability to counter future shocks and sustainability finance its longer-term inclusive growth agenda.

The fiscal deficit in 2021 is projected to narrow to 5.4 percent, mainly driven by an increase in output. Although government expenditure is projected to rise in 2021, the expected increase in aggregate GDP and government revenue collection is likely to lead to a narrower budget deficit. The primary deficit is also projected to shrink to 2.9 percent of GDP in 2021, down from 3.6 percent in 2020.

The government's Medium-Term Fiscal Framework (MTFF) targets a fiscal consolidation path to reach a budget deficit averaging at around 4.5 percent of GDP over the period 2021-2023. The MTFF assumes an average GDP growth rate of 4.5 to 5.5 percent over the next three years. Furthermore, it assumes an average crude oil price of USD45 to 55 per barrel coupled with a projected daily production of 580,000 barrels. A new Medium-Term Revenue Strategy (MTRS) aims to broaden the revenue base, identify new sources of tax, reduce leakages (including via the informal sector) and enhance targeting of tax incentives.


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Economic outlook

While the global economy is expected to improve going into 2021, output is not expected to return to pre-pandemic levels in the near term. The global economy is projected to grow at the rate of 4.2 percent in 2021, after contracting by 5.2 percent in 2020. This recovery is predicated on a gradual improvement in confidence, consumption, and trade, assuming the rollout of an effective vaccine starting in early 2021. In the East Asia Pacific region, growth is expected to strengthen to 6.6 percent in 2021 (2020f: 0.5 percent), led by a strong rebound in China.

Malaysia's economy is projected to grow by 6.7 percent in 2021. This rebound can be attributed to a low base in 2020, continued improvements in exports and a gradual build-up of momentum in private consumption and investment.

The strength and timing of Malaysia's economic recovery will depend largely on the timely availability of an effective mass vaccination program. Malaysia is expected to receive its vaccine supply in stages, with the first batch of COVID-19 vaccines expected to arrive in Q1 2021, which would allow the vaccination of at least 20 percent of the Malaysian population by the end of 2021. The vaccine rollout is likely to boost consumer and business confidence, contributing to a gradual strengthening of private sector activity.

Consumption and investment are expected to see a return to growth. As the key driver of growth, private consumption is expected to rebound to 7.4 percent growth (2020f: -4.8 percent), benefitting from better management of COVID-19, prospects of improved labor market conditions, continued support from pandemic related stimulus measures including personal income tax reductions and tax reliefs, cash transfers and targeted repayment assistance provided by BNM. Gross fixed capital formation is projected to turnaround and grow by 7.2 percent (2020f: -13.4 percent), supported by expansions in public and private investment.

Exports will likely gain momentum on the back of recovering global demand. In the absence of another wave of infections, exports will likely register stronger growth of 8.9 percent in 2021 (2020f: -9.3 percent) as global demand firms. The recovery in economic activities in regional countries, led by China, will also contribute to improvements in goods exports.

Headline inflation is projected to increase modestly in 2021. The average consumer price inflation rate is projected to increase to 0.8 percent next year (2020f: -1.0 percent). Underlying inflation is expected to be broadly contained into 2021 in the absence of immediate domestic cost pressures.

Despite the rebound in growth in 2021, it is anticipated that in the medium term, the Malaysian economy's output will only gradually return to its pre-pandemic levels. With the pandemic leaving

indelible scars on productivity through its effects on investment, labor supply and human capital, this is expected to generate substantial headwinds in the recovery process and see the economy modestly progress toward the path of economic activity projected before the COVID-19 pandemic.

The growth outlook is subject to considerable downside risks. On the external front, unexpected delay in the global rollout and distribution of vaccine could lead to "on-and-off" lockdowns in advanced economies and amplify downside risks to growth. Domestically, a prolonged and ineffective containment of the third wave of outbreak in Malaysia could see the current CMCO in high-risk areas be extended and the number of vulnerable households without adequate support remain elevated. Furthermore, ongoing domestic political uncertainty could continue to dampen private investment sentiment.

In the near term, containing the COVID-19 outbreak and protecting the most vulnerable remain the topmost priorities to prevent a more protracted downturn. This requires sustained efforts to ensure smart containment through appropriate mitigation and control measures, including targeted CMCO and EMCO in high-risk areas; large-scale testing; and contact tracing to limit the spread of the virus. Lack of certainty regarding the extent, duration and severity of the renewed outbreak and its economic consequences suggest that additional targeted social spending may be required.

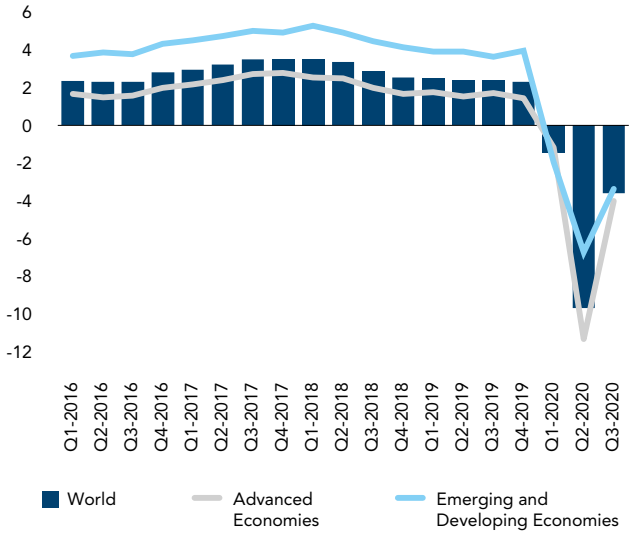
As health risks diminish and economic recovery is underway, the policy focus will need to shift towards facilitating necessary economic adjustments to enable new growth in the post-pandemic environment. This implies that temporary fiscal support to preserve existing jobs and firms should be gradually phased out as conditions improve, while measures to incentivize job creation and investment in expanding sectors and facilitate upskilling and reskilling of workers could be expanded.

As the recovery becomes more entrenched, fiscal policy should refocus on rebuilding buffers to counter future shocks and on sustaining public financing to ensure higher levels of inclusive, long-term growth. Fiscal policy should strive towards raising revenue and enhancing spending efficiency. In terms of revenue, the government may consider strategies that prioritize increasing the progressivity of the personal income tax framework; removing exemptions from consumption taxes on non-essential items; expanding capital gains tax; exploring other forms of progressive taxes, including wealth taxes; maximizing gains from tax expenditures; and enhancing revenue administration. In terms of expenditure, the government may focus on containing the rising costs of public wage bill and pensions; improving the targeting of social spending; phasing out generalized subsidies; and strengthening public investment project selection and management.

After an initial rebound in Q3 2020, the global economic recovery has slowed in recent months

Global economic activity picked up considerably in 3Q 2020

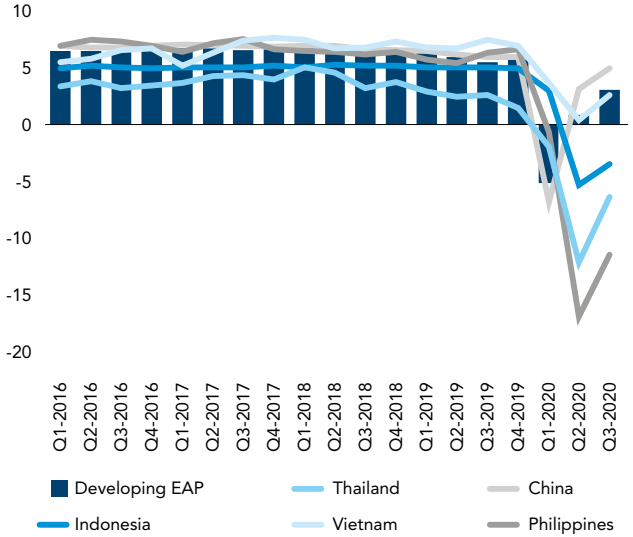
GDP, y/y, Percentage



Source: World Bank Global Economic Prospects

Economic conditions in the developing EAP have also improved, with significant cross-country differences

GDP, y/y, Percentage

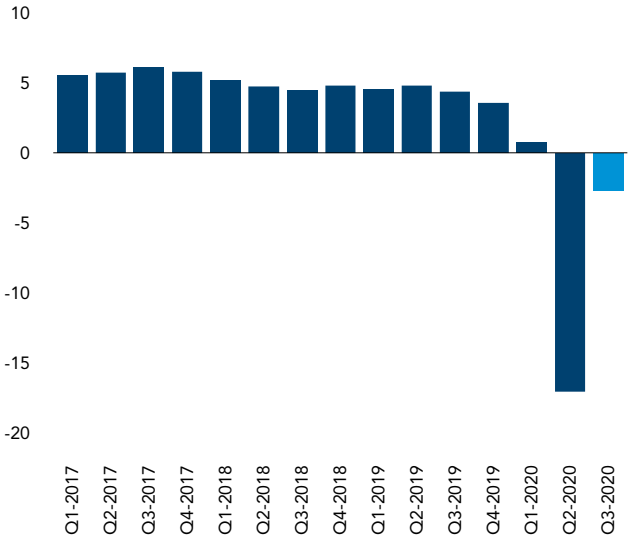


Source: World Bank Global Economic Prospects

Malaysia's economy recorded a smaller contraction in Q3 as movement restrictions were eased

Malaysia's economy posted a smaller contraction in Q3 2020...

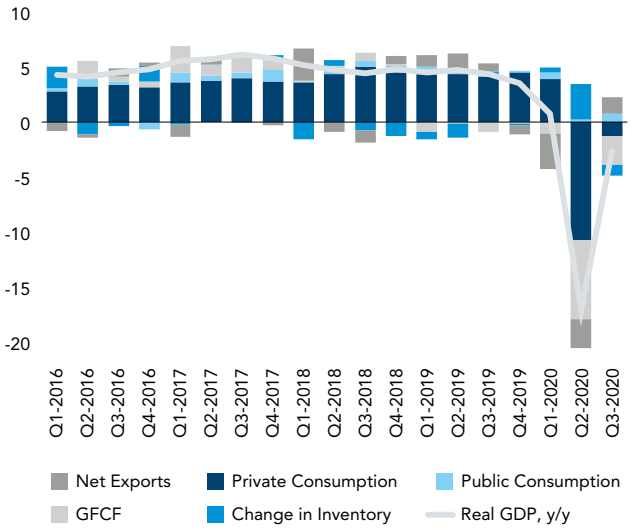
GDP, y/y, Percentage



Source: DOSM

...driven by an improvement in both domestic and external demand

Contribution to GDP, y/y, Percentage

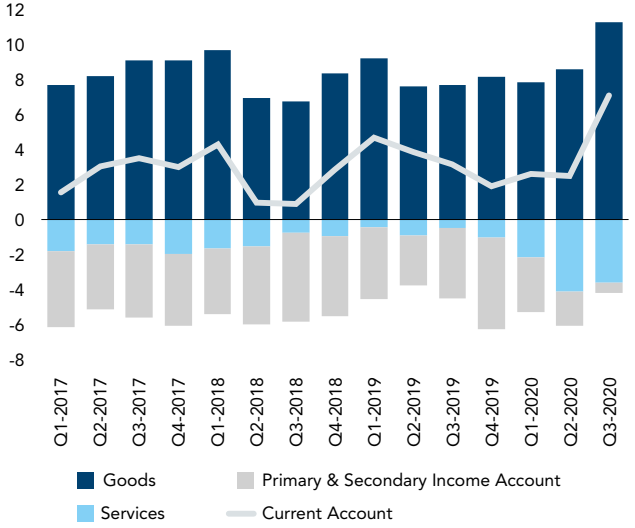


Source: World Bank staff calculations based on DOSM data

Improved external demand contributed to higher exports

Export recovery has been led by the E&E sector

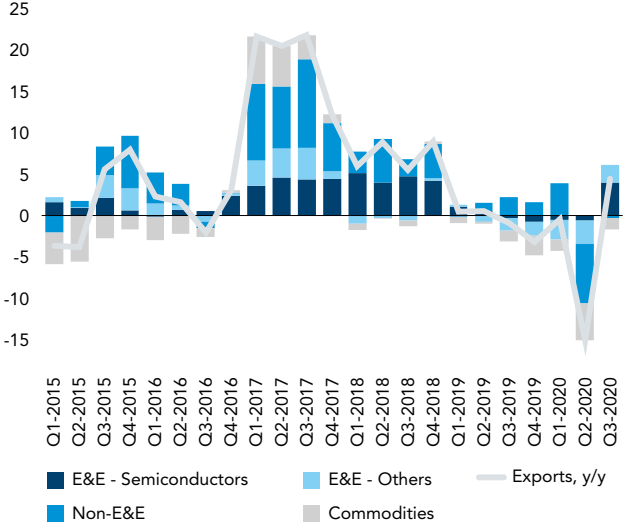
Current Account Balance, Percentage of GDP



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

The current account surplus increased considerably due to a higher goods surplus and a positive secondary income balance

Contribution to Export Growth, y/y, Percentage



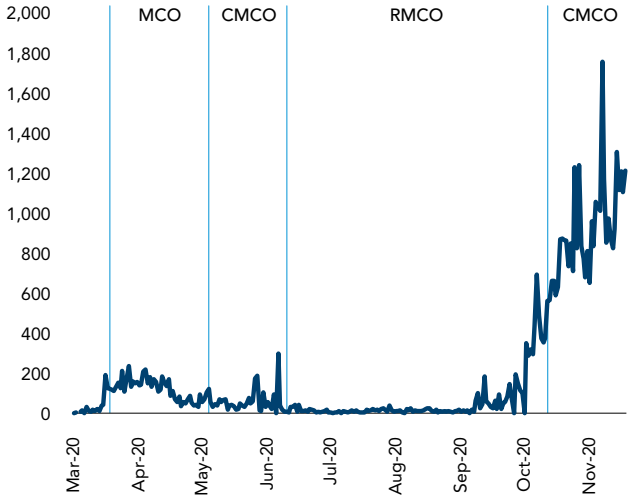
Source: World Bank staff calculations based on DOSM data


STOP
THE SPREAD
OF COVID-19
SPOILT
FOR CHOICE
AND HEAD
OVER HEELS.
McDonald's
WOLO
WE SERVE
WOLO
WOLO
GRAND MILLENNIUM
KUALA LUMPUR
207

A resurgence of COVID-19 infections and the re-imposition of the CMCO have dampened Malaysia's near-term economic recovery

The CMCO was re-introduced following the third wave of the pandemic...

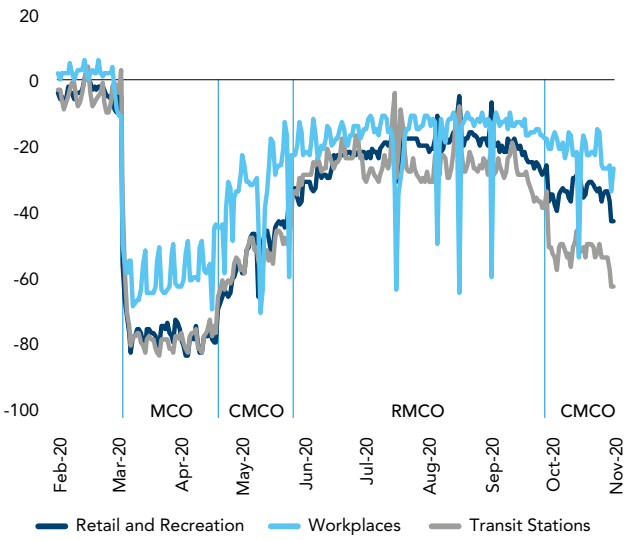
Number of New Daily Cases



Source: Oxford University's Our World in Data

...leading to a decline of mobility in public places compared to Q3 2020

Change Compared to Baseline



Source: Google Mobility Data

BOX 1

The Regional Comprehensive Economic Partnership: A welcome boost to investor confidence and international integration

The Regional Comprehensive Economic Partnership (RCEP) was signed on November 15, 2020 by representatives of 15 Asia-Pacific countries including China, resulting in the establishment of the world's largest trading bloc (see Figure 11). The group accounts for 30 percent of global GDP; 27 percent of global merchandise trade; 18 percent of services trade; and 19 percent of FDI outflows. With the RCEP negotiations commencing between ASEAN member states and dialogue partners in 2013, their conclusion with the promulgation of the treaty provides a welcome boost to international integration at a time when protectionism has been on the rise.

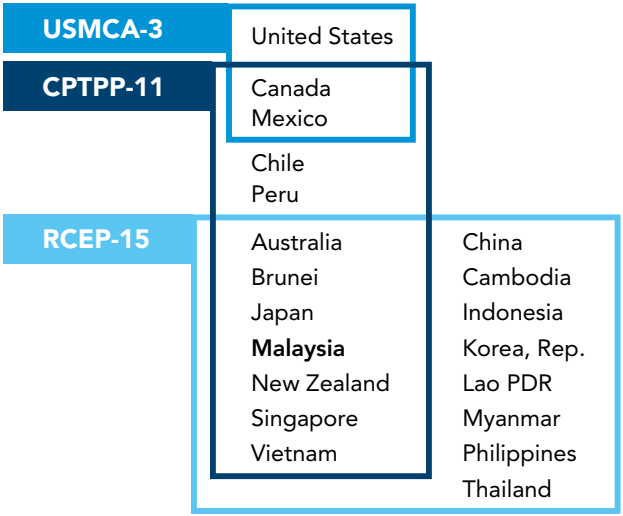
The agreement will deepen trade and investment relations between member countries mainly through reductions in non-tariff barriers on goods and services trade. It harmonizes the provisions imposed by countries on the trade in goods, thus providing more certainty for traders and investors. For example, it encourages importing countries to accept the product standards of other member countries from where the good originates if those countries provide the same level of consumer protection.

Importantly, the agreement aligns rules of origin for all 15 countries, allowing RCEP participants to integrate into the same production network or regional value chain. RCEP contains relatively strong provisions to protect intellectual property. It requires commitments by each member to refrain from discriminating against other members' investors in several service sectors. It also facilitates the temporary movement of individuals for investment and trade activities.

Preliminary modelling estimates suggest that Malaysia is expected to see gains of about 1 percent of GDP as a result of its participation in the RCEP (see Figure 12). Exports are projected to rise by approximately 5 percent and imports by 7 percent. The gains may be higher under an alternative scenario that factors in potential productivity gains resulting from increased openness. The GDP impact of RCEP for Malaysia is broadly equivalent to that from the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) (without the US). The equivalence reflects the relative breath of the RCEP (covering 30 percent of global GDP, compared to 14 percent for the CPTPP), with the greater depth of commitments under the CPTPP. The RCEP is expected to come into force towards the end of 2021. Malaysia has still yet to ratify the CPTPP.

FIGURE 11
Malaysia is at the center of new regional integration initiatives

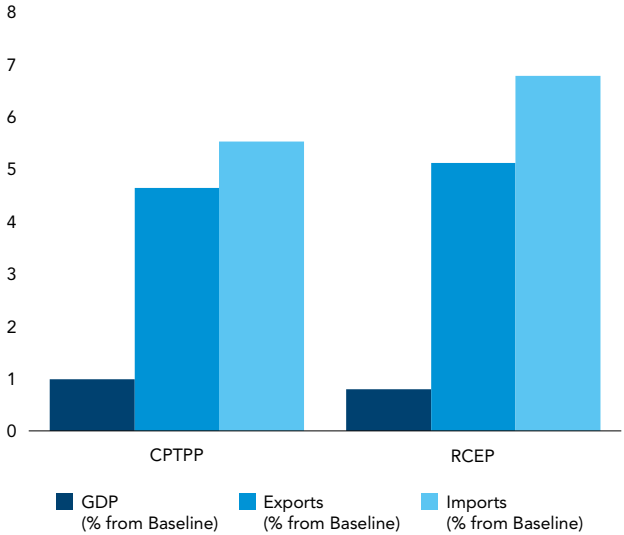
Trade Agreement Membership in the Asia-Pacific Region



Source: World Bank staff illustration

FIGURE 12
Malaysia is expected to see a net gain of around 1 percent of GDP from the RCEP

Model Simulations of Cumulative Percentage Changes to GDP, Exports and Imports for Malaysia in 2030

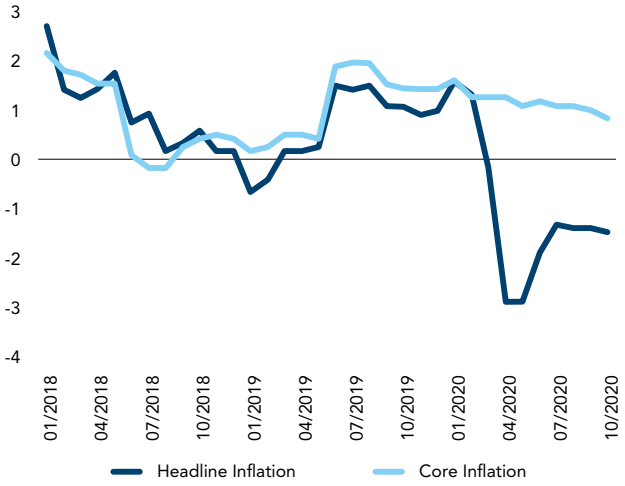


Source: World Bank staff estimates

Headline inflation remained negative in recent months, while underlying inflation continued to be benign

Headline inflation remained negative in recent months...

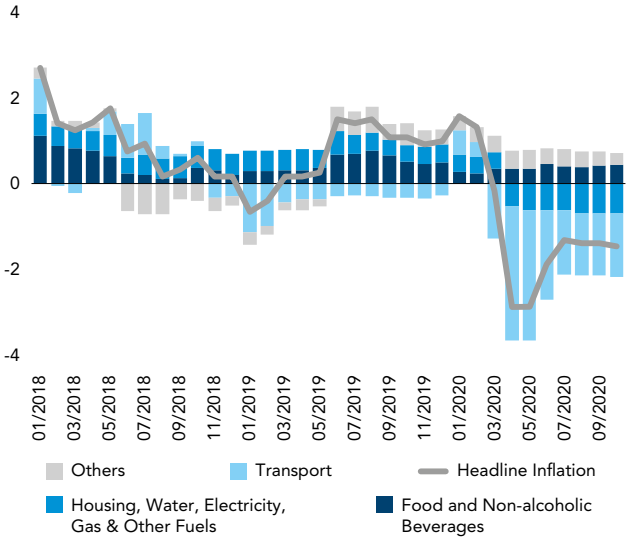
Inflation, y/y, Percentage



Source: World Bank staff calculations based on DOSM data

...driven by lower retail fuel prices

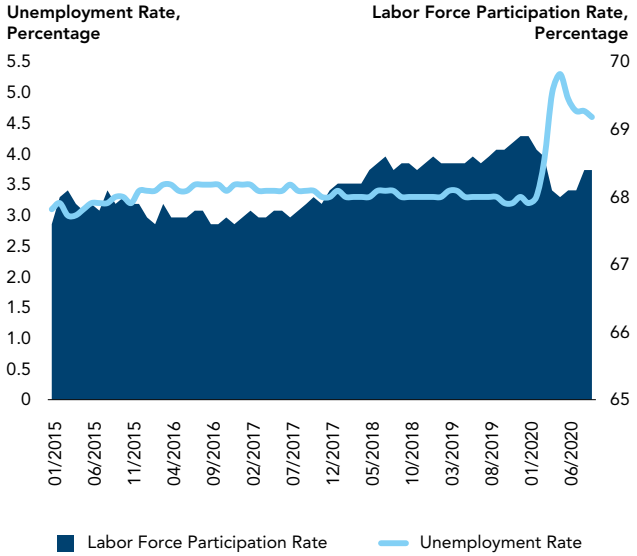
Contribution to Inflation, y/y, Percentage



Source: World Bank staff calculations based on DOSM data

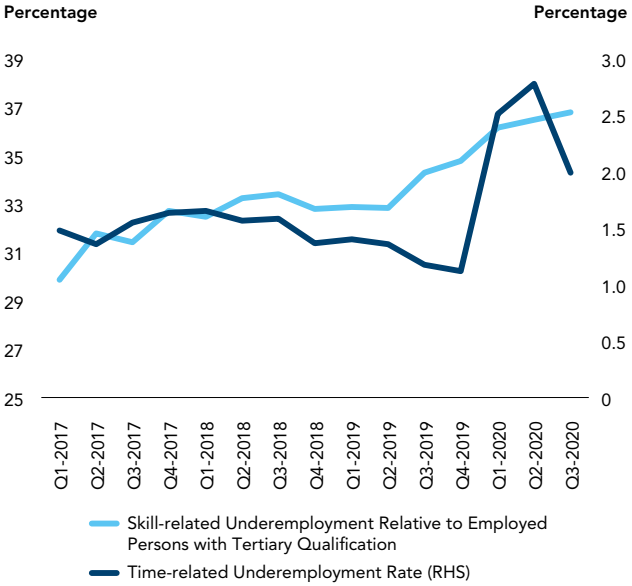
While unemployment has moderated slightly, under-employment remains elevated

Unemployment rate moderated slightly from its peak in Q2 2020



Source: World Bank staff calculations based on DOSM data

Movement restrictions contributed to relatively high underemployment rates



Source: World Bank staff calculations based on DOSM data

BOX 2

How many Malaysians can work from home?

Mobility restrictions imposed to curb the health impact of the COVID-19 pandemic has adversely affected many workers, particularly those with jobs that cannot be performed from home and require high levels of physical proximity. As long as COVID-19 remains a health risk, the ability to work from home provides an indication of vulnerability to job loss with mobility restrictions in place, while the degree of physical proximity is an indicator of the likelihood that a worker can return to work, even if mobility restrictions are gradually lifted. Estimates for Malaysia suggest that 64.5 percent of jobs cannot be performed from home, after adjusting for internet access, while about 50.9 percent of jobs require high levels of physical proximity (see Abdur Rahman, Jasmin and Schmillen 2020).

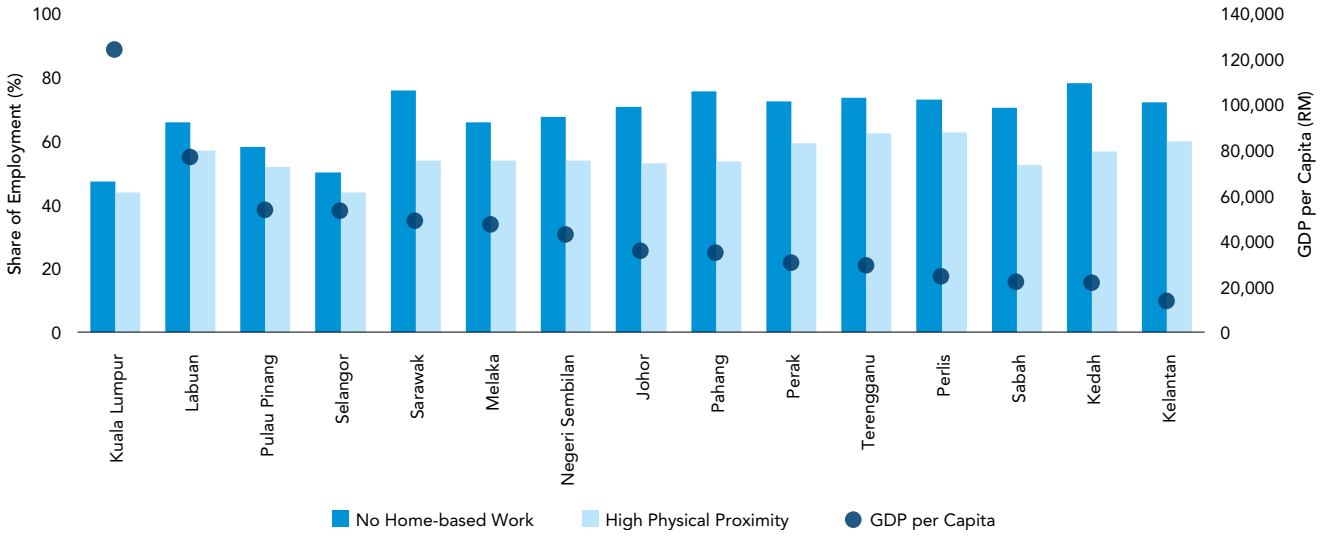
Workers in less developed states are more vulnerable to job losses during the COVID-19 crisis. In Putrajaya, the state or federal territory with the lowest share of jobs vulnerable to COVID-19, only 29.3 percent of jobs cannot be performed from home, and only 32.1 percent of jobs require high levels of physical proximity. Workers in Kuala Lumpur are also relatively less vulnerable, where 47.1 percent of jobs cannot be performed from home and 43.7 percent of jobs require high levels of physical proximity, as shown in Figure 17. In contrast, 78.1 percent of jobs in Kedah cannot be performed from home, while 56.6 percent of jobs require high levels of physical proximity. In Perlis, 62.6 percent of jobs require high levels of physical proximity, the highest in the nation. Additionally, there are negative correlations both between GDP per capita and the share of jobs that are not conducive to home-based work, and between GDP per capita and the share of jobs that involve high levels of physical proximity. The correlation coefficients for the two relationships are -0.77 and -0.65 respectively, suggesting that workers in less developed states are more vulnerable to job losses during the COVID-19 crisis.

Vulnerability is highest among those already more economically at risk prior to the crisis, including workers with relatively low levels of income and education, and the self-employed. Less than one fifth of workers in the lowest income decile are able to work from home, compared to more than three fifths of workers in the highest income decile. Similarly, only one out of ten workers without a formal education are able to work from home, compared to eight out of ten workers with tertiary education. Own account workers and unpaid family workers are also more likely to have jobs that cannot be performed from home compared to employees. Workers from rural areas and women are similarly likely to have jobs that cannot be performed from home, or that require high levels of physical proximity. Compared to prime-aged workers age 25 to 54, youth and older workers are also at greater risk of losing their jobs.

FIGURE 17

Workers in less-developed states are more likely to have jobs that cannot be performed from home and require high levels of physical proximity

Plot Share of Employment vs. GDP per Capita by Scale

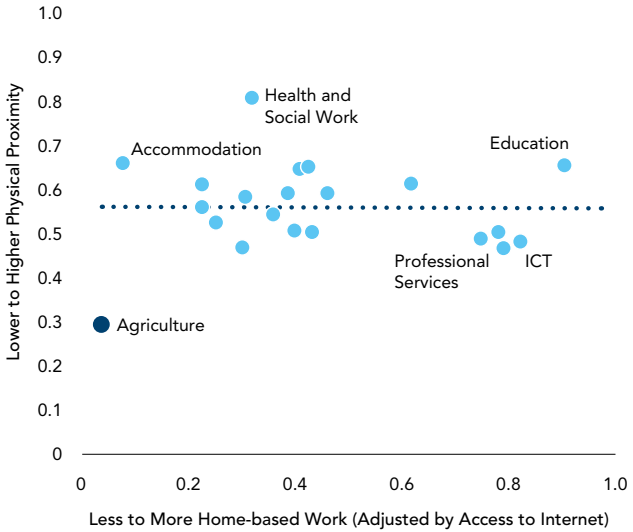


Source: World Bank staff calculations based on Dingel and Neiman (2020), Garrote Sanchez et al. (2020), O*NET and Department of Statistics Malaysia
Note: GDP per capita for W.P. Kuala Lumpur includes that for W.P. Putrajaya.

BOX 2 (Continued)

FIGURE 18
Workers in the agriculture sector are least likely to be able to work from home...

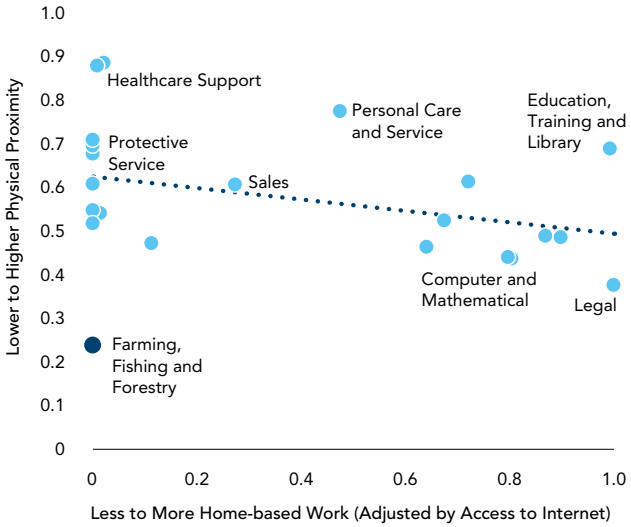
Plot of Physical Proximity vs. Frequency of Home-based Work by Sector



Source: World Bank staff calculations based on Dingel and Neiman (2020), Garrote Sanchez et al. (2020), O*NET and Department of Statistics Malaysia

FIGURE 19
...many of whom are involved in farming, fishing and forestry related occupations

Plot of Physical Proximity vs. Frequency of Home-based Work by Sub-sector



Source: World Bank staff calculations based on Dingel and Neiman (2020), Garrote Sanchez et al. (2020), O*NET and Department of Statistics Malaysia

As expected, workers in the agriculture sector and workers involved in farming, fishery and forestry related occupations have the least ability to work from home. Figure 18 and Figure 19 visualize the relationship between the ability to work from home and the level of proximity involved in different sectors and occupations, and show that while work in agriculture requires relatively low levels of physical proximity, it also—for obvious reasons—cannot be performed from home.[1] These findings place agricultural workers highly vulnerable to job and income loss when strict mobility restrictions and work-at-home orders are in place.

As long as mobility restrictions are in place to curb COVID-19 infections, income support in the form of direct cash transfers should be continued to support vulnerable workers. Further rounds of cash transfers targeted at the B40 – the group that needs the most support – will remain vitally important. These transfers provide short-term relief to mitigate acute financial strains, they support medium-term recovery efforts, and they support consumption and human capital development at a time of economic downturn. In addition, there is an increased and urgent need for skills-building programs that can enhance workers' skills, focusing on those less susceptible to automation in the advent of rapid technological change that has been accelerated by the current crisis, such as digital and socioemotional skills (see World Bank 2018 and Chernoff and Warman 2020). In this current environment, these skills are also required to obtain jobs that can be performed from home. The government has already made steps in the right direction by providing incentives for the upskilling and reskilling of workers in Malaysia's short-term economic recovery plan, *Penjana*, and by the inclusion of similar initiatives in Budget 2021. It is important for efforts to continue in this direction as Malaysia pursues economic recovery.

[1] 83 percent of workers in the agriculture sector are employed in farming, fishing and forestry related occupations.

The financial sector remained resilient through Q3 2020

Bank Negara Malaysia has kept the overnight policy rate (OPR) at 1.75 percent since July 2020

- It expects GDP growth for 2020 to be within the earlier forecasted range of -3.5 to -5.5%

Banks have maintained healthy capital and liquidity positions

- Impairment ratios edged upwards in October, albeit from historically low levels, driven by the household segment

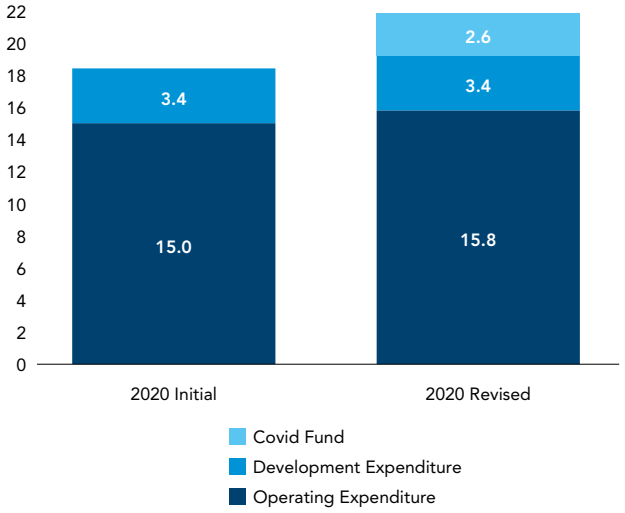
Net financing expanded in Q3 2020

- Household loans grew at a faster pace on higher car purchase and personal loans
- Business loans grew at the more modest pace with a slower disbursement of loans for working capital purposes

The economic downturn and the government's response have led to a wider fiscal deficit in 2020

Expenditure for 2020 was revised upward due to COVID-19 related spending

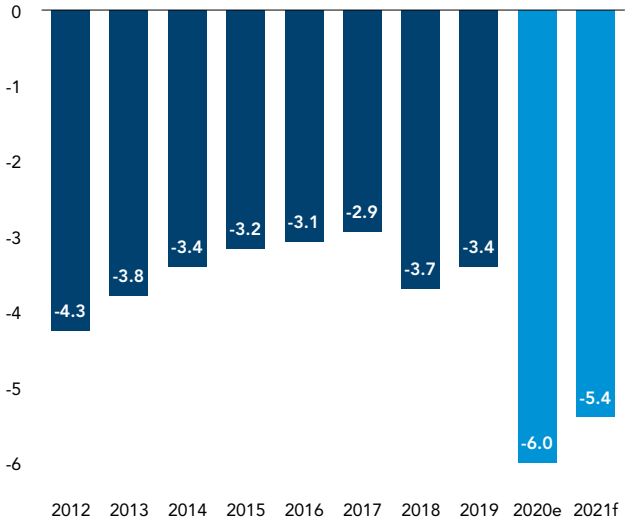
Federal Government Expenditure, Percentage of GDP



Source: World Bank staff calculations based on MOF data

The budget deficit is expected to reach 6 percent of GDP in 2020

Federal Government Fiscal Balance, Percentage of GDP

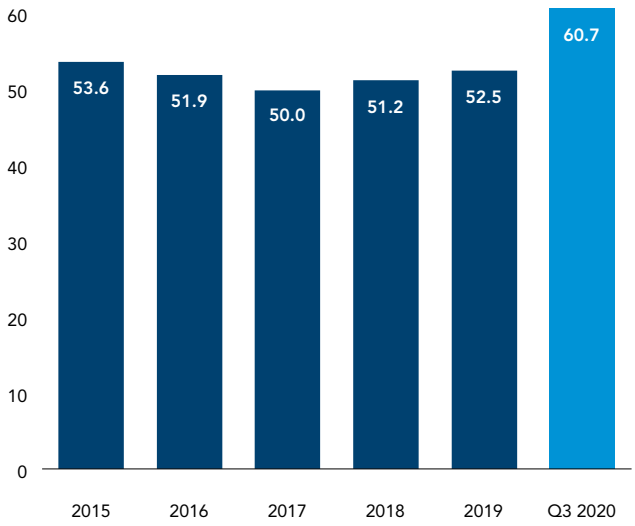


Source: World Bank staff calculations based on MOF data

The wider fiscal deficit led to an increase in federal government debt

In line with a wider budget deficit, government debt rose in 2020...

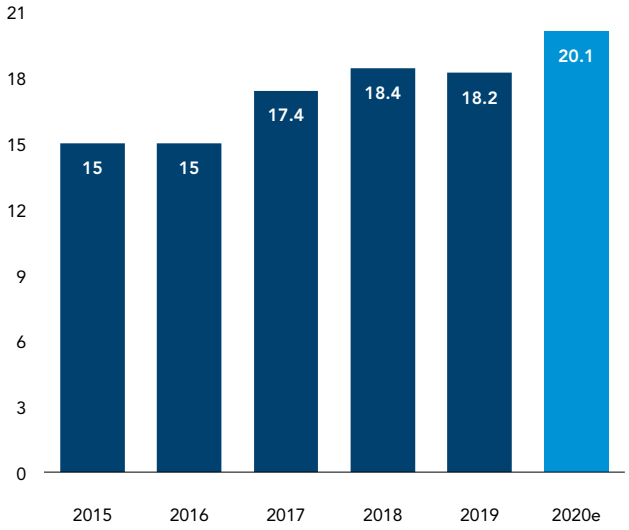
Federal Government Debt, Percentage of GDP



Source: World Bank staff calculations based on MOF data

...along with higher government guarantees due to increased borrowing by GLCs

Government Guarantees, Percentage of GDP

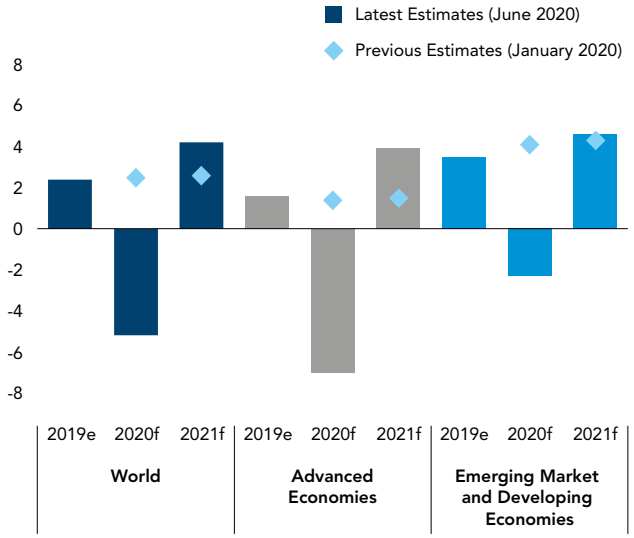


Source: World Bank staff calculations based on MOF data

Global growth is projected to rebound in 2021, but output is not expected to return to pre-pandemic levels in the near term

Global GDP is projected to improve in 2021 as confidence, consumption, and trade gradually strengthen

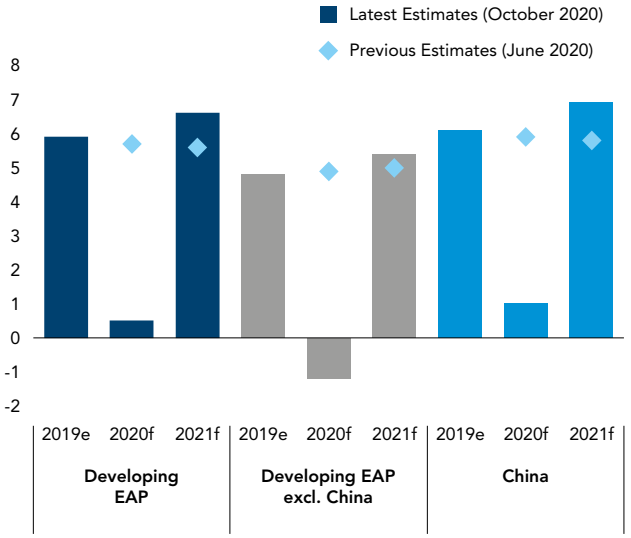
GDP, y/y, Percentage



Source: World Bank staff projections

Regional growth is projected to accelerate in 2021, led by a strong rebound in China

GDP, y/y, Percentage

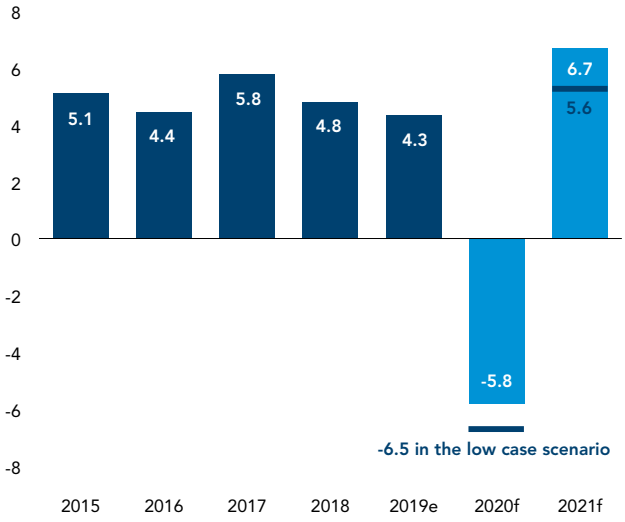


Source: World Bank staff projections

Malaysia's economy expected to return to growth in 2021

Malaysia's economy is forecast to grow by 6.7 percent in 2021, after contracting by 5.8 percent in 2020...

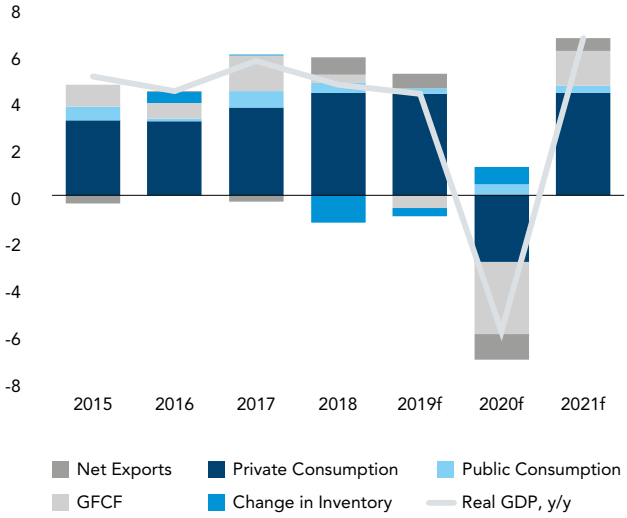
GDP, y/y, Percentage



Source: World Bank staff calculations based on MOF data

...reflecting a broad-based rebound in consumption, investment and exports

Contribution to GDP, y/y, Percentage



Source: World Bank staff calculations based on MOF data

The growth outlook is subject to considerable downside risks

Source: World Bank staff illustration

Containing the COVID-19 outbreak and protecting the most vulnerable remain the topmost priorities over the near term

Containing the current wave of the COVID-19 pandemic remains vital

Sustained efforts to ensure smart containment through appropriate mitigation and control measures are crucial to ensure a safe resumption of economic activity

Additional targeted social spending may be required

Lack of certainty regarding the duration and severity of the renewed outbreak and its economic consequences suggest that additional targeted social spending may be required

Enabling new growth in the post-pandemic environment

As health risks diminish and as the economy recovers, the policy focus will need to shift towards facilitating necessary economic adjustments to enable new growth in the post-pandemic environment

BOX 4

Malaysia's upgraded poverty line and the implications for policy

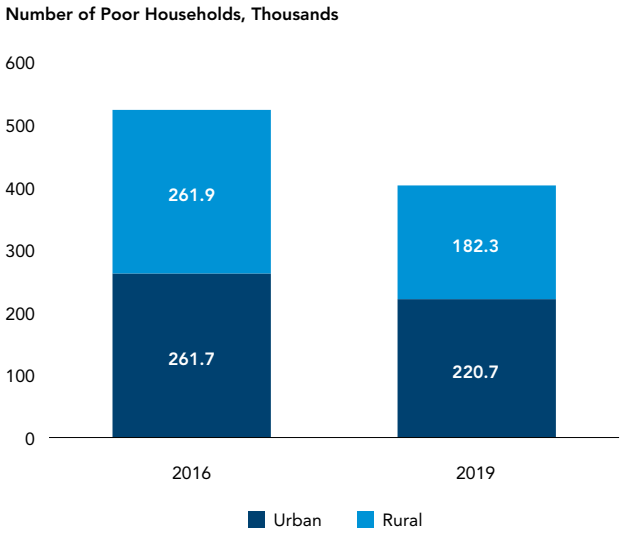
In July 2020 the government announced that it had revised its official poverty standard, or "poverty line income" (PLI). The announcement of this revision coincided with the release of results from the 2019 Household Income and Expenditure Survey (HIES). This was the first revision to the poverty line methodology since 2005. More importantly, it was the first time that the poverty line had been revised in real terms (that is, after adjusting for inflation) since the PLI was first established in 1977. Since then, prior to the current revision, while Malaysia's GDP per capita at more than quadrupled, with dramatic increases in general living standards, there had been no revision to the poverty threshold. While the previous PLI may have been appropriately set for a lower-middle income country, as Malaysia was in 1977, the new PLI is more closely aligned with citizens current needs and expectations.

DOSM estimates that 5.6 percent of Malaysian households were living below the poverty line in 2019. While this is considerably higher than the 0.4 percent estimated in the 2016 HIES, it certainly does not indicate that poverty has increased in real terms. Rather, it reflects the fact that the minimum standard for acceptable standards of living has been increased. If the new PLI is applied to the 2016 data, it can be seen that according to the new standard, poverty has actually declined, with the poverty rate according to the new standard standing at 7.6 percent in 2016. As with the previous PLI, the revised PLI takes into consideration differences in prices between different states and between urban/rural areas. Therefore, the poverty lines in many of these states are lower than the national average of RM2,208 per month for an average household. For example, the average PLI in Perak is RM2,077.[5]

The revised PLI casts great lights on the true nature and extent of poverty in Malaysia, enabling policymakers to assess and manage it far more effectively. Under the previous PLI, the issue of poverty had almost disappeared from public view, with the proportion of those falling below the poverty line standing at less than one percent. As a result, the attention of policymakers turned more to a much larger group, the B40. While the needs of this group are also significant and worthy of policymakers' attention, the needs of the poorest group, the B10, are considerably different from those in the 4th income decile (B31–B40). The new PLI can facilitate greater differentiation and the better targeting and formulation of policies and programs for the poorest Malaysians.

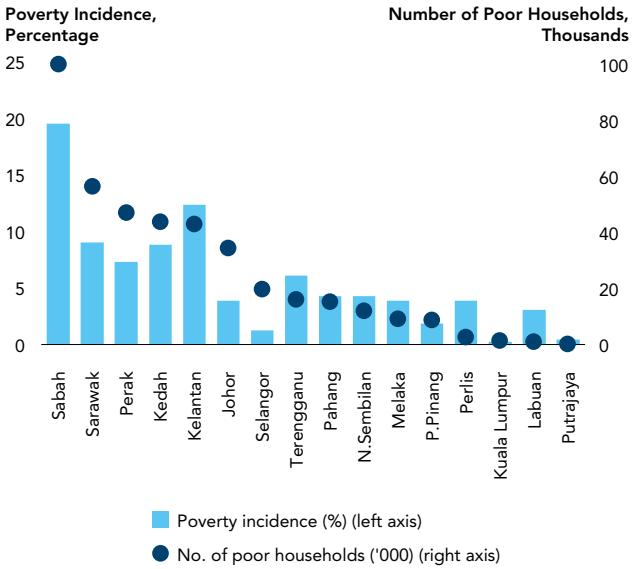
[5] The figure RM2,208 is frequently cited as the new PLI. However, the PLI methodology calculates household-specific PLIs for each household in the HIES, taking into household needs as determined by the size and composition of the household, and the local prices for basic food and nonfood necessities. In 2016 cost of basic needs in Sabah was more than 60 percent higher than the costs for the same items in Kelantan (World Bank, 2020).

FIGURE 39
Most poor households live in urban areas



Source: World Bank staff calculations based on METS data

FIGURE 40
The largest numbers of poor households live in Sabah, Sarawak, Perak, Kedah and Kelantan



Source: World Bank staff calculations based on METS data

BOX 4 (Continued)

Some useful insights may be drawn from the geographic distribution of poverty, as measured by the revised PLI. For example, as in most countries, poverty rates in Malaysia are higher in rural areas than in urban areas, standing at 12.4 percent and 3.8 percent, respectively, in 2019. However, because Malaysia is highly urbanized, the majority of poor Malaysians (55 percent) live in urban areas (see Figure 39). Between 2016 and 2019, the number of urban poor households declined by only 16 percent as compared to the reduction in the number of rural poor households (approximately 30 percent). The discrepancy in poverty reduction rate in urban versus rural areas may be due to rapid urbanization across Malaysia as well as a strong government focus on alleviating rural poverty for many years. Therefore, this calls for a reassessment of the often-held view that poverty in Malaysia is largely a problem of remote and isolated areas.

Poverty is concentrated in a handful of states, with one in four Malaysians below the revised poverty line living in Sabah. Five states, Sabah, Sarawak, Perak, Kedah and Kelantan, account for more than 70 of poor households (see Figure 40). In particular, Sabah stands out for having both the highest poverty rate (19.5 percent) and the largest number of poor (more than 100,000 households). As discussed in Box 2, the least-developed states including Sarawak, Kedah, and Perlis have the highest share of workers vulnerable to movement restrictions and the pandemic. Workers in less-developed states are more likely to be affected with job losses as their jobs demand high levels of proximity and cannot be performed from home. Thus, there is a strong argument for concentrating poverty alleviation efforts and welfare-support policies in the most lagging states, while at the same time maintaining an awareness of the increasing share of the poor in urban areas.

Despite a lack of representative data, there can be no doubt that the poverty rate has increased as a result of the COVID-19 pandemic and the associated control measures. The limited data available (for example, online surveys with unrepresentative samples and highly localized surveys in PPRs in the Klang Valley) suggest that poorer households have been hit the hardest. Disproportionate numbers of the poor and vulnerable work in low-skilled occupations, with working from home not an option. Many others have had to face disproportionately high levels of risk, working in high-risk, low-paid essential service jobs. Informal workers and those who are self-employed were much more likely to suffer employment and income losses, with the long-known issue of insufficient savings buffers having become critical across a range of households. Evidence from other countries indicates that compared to those who were poor before the COVID-19 crisis, the "new poor" are more likely to be urban, to have higher levels of education, and to work in occupations outside of agriculture. In short, the crisis has altered the face of poverty, requiring adaptation on the part of policy makers.

As economic conditions improve, fiscal policy should refocus on rebuilding buffers

Collecting more

Personal income tax
Increasing the progressivity of the personal income tax framework

Consumption tax
Removing exemptions from consumption taxes on non-essential items

Capital gains tax
Expanding the current capital gains tax beyond property gains tax

Other progressive taxation
Exploring other forms of progressive taxation including wealth and carbon taxes

Spending better

Wage bills and pensions
Containing the rising costs of public wage bill and pensions

Social spending
Better targeting and increasing the depth of social spending

Blanket subsidies
Gradual phasing out of generalized subsidies

Public investment management
Strengthening public investment project selection and management

Source: World Bank staff illustration

PART TWO

Sowing the Seeds

Sowing the seeds

Malaysia's agricultural sector has been a key enabler of the country's economic transformation over the past fifty years. The sector has played a critical role in Malaysia's development by supplying food to an urbanizing population, releasing labor to the non-primary sectors, providing inputs used in agro-processing and other forms of manufacturing, generating investible capital, and earning foreign exchange. Today, the agricultural sector is the smallest economic sector, behind services and industry, accounting for approximately 11 percent of employment and 7 percent of GDP.

Yet the COVID-19 crisis has highlighted the continued importance of the agricultural sector to the country going forward; and this edition of the MEM looks at the potential role of a strengthened agrofood economy in achieving shared prosperity, sustainable long-term economic growth, and other national priorities. When it first struck, the pandemic brought food into focus because a situation involving economic shutdowns of such unprecedented scale necessarily raised concerns about the security and dependability of food access and supply. And while worst-case scenarios have not played out, the crisis has indeed had ripple effects on the food economy with impacts on food security and welfare that have yet to be fully assessed.

The pandemic has brought attention to the multifaceted and interconnected nature of Malaysia's food system, with increased focus on issues related to food security and agrofood policy in broader terms. Today, food insecurity often relates more to problems of diet quality, healthy food affordability, and food choices, than to shortages of staple food availability. And this has continued to be true during the pandemic as food insecurity has been fueled more by the loss of income than by the initial short-lived disruptions that affected food supply. Meanwhile, it is not just the crisis that invites renewed interest in and a new perspective on agriculture.

Just as COVID-19 has brought the food system into national focus together with new perspectives on food security, accession to high-income status will also offer a new lens through which Malaysia will view its agrofood sector. In high-income contexts in which the day-to-day concerns about the adequacy of staple food supply are largely allayed, societies tend to start expecting more of their food systems. Better performance comes to be expected across a widening set of domains as growing attention is paid to value addition, the quality of diets, the environmental footprint of food across its lifecycle, labor protections for food chain workers, animal welfare, and the vibrance of food culture.

From either standpoint, despite obvious strengths, Malaysia's current agricultural policy seems to have some "blind spots:" under-appreciated and under-addressed risks and opportunities for food security and agrofood system development. In particular, despite the declining place of rice in Malaysians' diets or the agro-economy, Malaysia spends more public resources on rice than on any other agricultural product. Furthermore, resources supporting the rice sector are mostly channeled through instruments of a highly

protectionist and market-distorting kind. These aspects of agricultural policy have seemingly contributed to Malaysia having a two-speed agricultural economy in which the agrofood side of the sector—as distinct from the plantation side—has significant unfulfilled potential.

Malaysia has huge underexploited potential to serve the varied demands of a modern agrofood economy, both domestically and regionally. While national agrofood policies have remained focused on target levels of rice self-sufficiency, Malaysia has become increasingly reliant on net imports of much of the higher-value foods it eats; and it has not become a major exporter of fruits and vegetables as its own consumption of these products has risen. Malaysian households already spend about three times more on fruits and vegetables and more than twice as much on breads and other cereals than on rice. Not only domestically but across Asia, ongoing demographic shifts are changing how much consumers spend on food, how and where they shop for it, what and where they eat, and even what they value in food. Malaysia is nearly 80 percent urbanized and its middle class is expanding; and the entire Asian middle class could expand to 3 billion people within a decade.

These demographic, socioeconomic, and cultural changes point to significant growth possibilities for private businesses and jobs to develop up and down food supply chains. They lie not only in the production of more diverse and higher-value food products but also in the development of advanced farm technology and service industries, food processing, logistics and wholesale, and further downstream, a diversity of food services and retail formats addressing both consumer and post-consumer needs. In the upstream segments of food supply chains (that is, for the agricultural sector), the name of the game will be to better respond to, link, or even help shape food sector changes. And as it does so, the fact that the agricultural sector has been a latecomer to the digital economy only points to further growth potential. In this and other domains, Malaysia will benefit from investing in human and social capital, innovation, quality infrastructure, and risk management.

> By modernizing and diversifying its agrofood sector and better integrating it with its "farm-to-fork" food economy, Malaysia could help advance other national priorities

Doing so could help Malaysia to more fully leverage its rich food culture and agricultural potential to dynamize its urban economy and brand itself globally. To date, Malaysia has not used its food sector as much as possible to market itself to investors or global talent, to cultivate familiarity or an image of modernity, safety, or stability—as Thailand has to its advantage. Malaysia can still do more to differentiate itself, through its agrofood exports, as a purveyor of superior products in terms of flavor, variety, sustainability, safety, Halal-compliance, labor protections, or any number of other aspects

of quality—thereby creating a "halo effect" of potential benefit to other sectors of the economy.

Meanwhile, Malaysia's rice-centric agricultural policy has inadequately addressed a number of existing and emerging challenges of the agrofood economy, including inequity, health, and environmental ones. In particular, while extreme poverty is nearly a reality of the past in Malaysia, including in rural areas, farming has largely remained synonymous with poverty of the relative kind. A large majority of the farmers growing the national staple food, rice, are among the poorest members of society (the B40). Malaysia also faces several dietary health challenges, including nutritional ones. Over one-fifth of its young children face diminished life prospects because they are stunted; and rates of chronic conditions like diabetes and high body mass have generally risen over the past decade. Malaysian agriculture is also contending with a widely shared rise in environmental stressors, climate change, and biosecurity risk. Notably, over 70 percent of emerging infectious diseases in humans have their source in animals and animal agriculture is one of their major vectors.

Although agriculture cannot "solve" poverty, chronic disease, or biosecurity challenges on its own, making health a key driver of agricultural policies will help make doing so more attainable. Malaysia has already adopted progressive policies including a sugar-sweetened beverage tax and a sodium reduction strategy to improve diet quality at the consumer level; but Malaysian agriculture is still lacking in nutrition-sensitivity. In addition to remedying that, Malaysia will also need robust strategies to mitigate various sector risks ranging from zoonosis to resource competition, pollution, and climate change. A focus on supplying a diversity of minimally processed, and multiply valuable plant-based foods will generally be helpful across all of these endeavors, including in attenuating nutritional, food safety, biosecurity, and environmental hazards, and in raising incomes.

Malaysia can expect more from its agrofood economy and should be deploying public resources accordingly. Today, the orientation and quality of public spending in agriculture needs to be re-assessed—both because of what it is doing, and what it is not. The problem is not that Malaysia cannot afford what it is spending on the agrofood sector. For a soon to be high-income country, the core issue to address is how to "spend better" in ways that align better with evolving food system aspirations. For example, Malaysia could be building an agricultural sector that is more responsive to the country's contemporary food economy, including by developing the capacity to supply more of the high-value foods that the region and Malaysia consume—including fragrant rice varieties. It could be developing a modern periurban farm sector connected to urban markets with advanced logistics. It could position itself to lead in the supply of "healthy and safe" produce to the region. It could be training and attracting a next generation of agrofood system entrepreneurs across a wide variety of disciplines. An agricultural sector vested with the belief that it can modernize and "change the world" will become one that Malaysia's youth and best minds want to join and work to build. If not that, the agricultural sector will likely continue to be a purveyor of low-quality and informal employment, and a magnet for economic precariousness, transience, and social instability.

Opportunities for new directions in agrofood policy are at hand: Malaysia has at least two major and immediate platforms to update its agrofood sector policies, better calibrating its objectives and means to higher standards and aspirations. In particular, the RMK12 will give Malaysia the chance to sustain its existing level of commitment to but redouble its belief in the potential of the agricultural and food economy. In this context, to strategically increase the efficacy and efficiency of agricultural public expenditure, Malaysia can, first, shift the strategic focus from increasing (paddy) production and (rice) self-sufficiency to policies that reflect a more holistic view of food security, agricultural growth and competitiveness, and rural development. In all of these areas, farm profitability, diet quality, food safety, environmental sustainability, and biosecurity would become central concerns. Second, Malaysia can intensify efforts to modernize and diversify the agrofood sector to boost the incomes of rural households. This will involve more balanced investment in the agrofood sector and policy reforms that enable and stimulate the private sector to develop in new and more rewarding directions. Third, it can focus spending more on public goods and provide private goods only to overcome well-defined market failures—with a view to stimulating productivity- and innovation-led as opposed to input-led growth.

In parallel to the RMK12, the rethinking of national food security strategy that is underway is an opportunity to bring appropriate balance to this area of policy. A better balance between ensuring a stable supply of rice on the one hand, and access to a diversity of healthy foods on the other, will be more effective, as will a rebalancing that accounts for the determinants of both urban and rural food insecurity. In light of persistent nutritional deficiencies and a rising burden of chronic disease, food security policy also needs to take a wider range of dietary health outcomes into consideration. For the agricultural sector, the overarching implication is to put less policy focus on paddy production and rice self-sufficiency. "Right-sizing" the place of rice in agricultural policy will, over time, enable Malaysia to produce and market a wider range of foods more affordably, while boosting access to them by supporting higher agricultural incomes.

Beyond the two entry points for reform already flagged, the opportunity exists to introduce an agrofood system perspective in other national policy initiatives and strategies. Those would include ones relating to developing the digital economy, combatting non-communicable diseases, planning for pandemic prevention and response, guaranteeing consumer protection (or food safety), adapting to climate change, expanding and enhancing higher education, designing smart cities, and other themes.

In the coming years, Malaysia will want to make every effort to modernize and diversify its agrofood sector and integrate it into its more dynamic "farm-to-fork" economy. Doing so will help it advance several national priorities; indeed, the food system, agriculture included, has broad relevance to inclusion, resilience, competitiveness, jobs, long-term economic growth, and sustainability. The needed reorientation of the aims and means of policy will also help the agrofood sector better align with what comes to be expected in a high-income country.

COVID-19 has brought food security into focus, inviting a new perspective on agrofood policy

The pandemic generated...

- Initially, fears about stability of food supply
- Ripple effects on food system
- Impacts still to be assessed

In the process it revealed...

- Food supply is robust
- Food insecurity is less about (rice) availability and more about food access and affordability
- Agrofood policy needs to focus more on nutrition and healthy diets

Malaysia's agricultural strategy has produced a strong but two-speed agricultural economy

Strong, dynamic tree-crops sector:

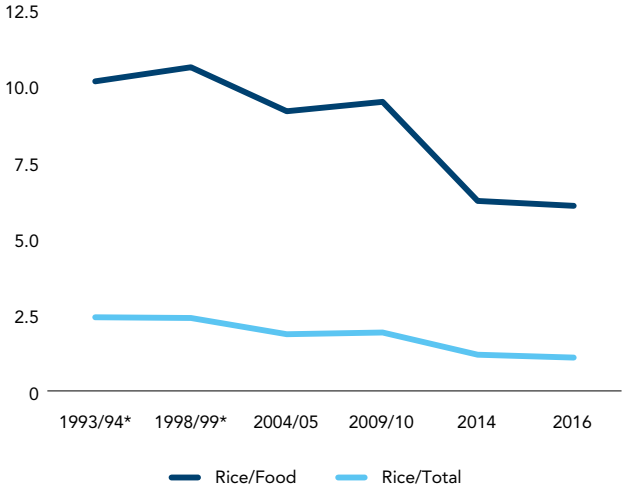
- Leading producer of oil-palm and rubber
- Significant value-add from downstream processing
- From oil palm: oil and kernel products, oleochemicals, bio-diesel, green plywood
- From rubber: tires, gloves, thread, footwear, catheters, surgical gloves, medical equipment
- From cocoa; Major processor of cocoa-butter

An agro-food sector that is considerably less dynamic

Agricultural policy has been dominated by rice self-sufficiency focus

The place of rice has declined to about 1 percent of Malaysian households' expenditures...

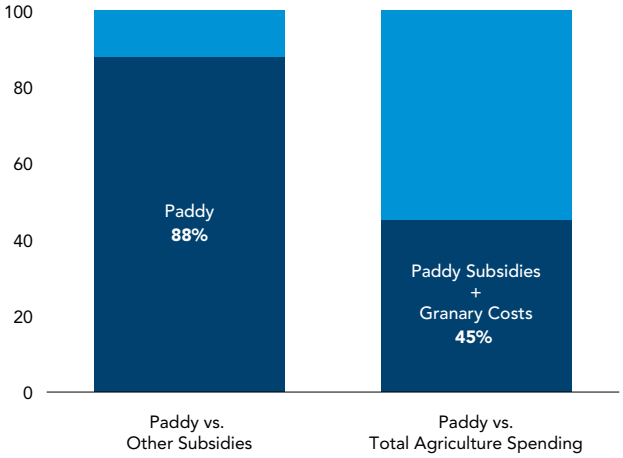
Rice as a Share of Household Expenditures, 1993-2016, Percentage



Source: World Bank 2019a

...but its dominance of the agricultural budget has been steadfast

Share of Agricultural Subsidies and Spending Devoted to Paddy, 2017, Percentage



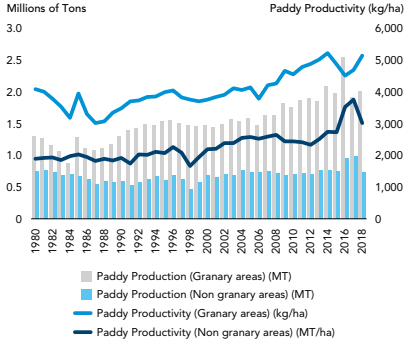
Source: Based on World Bank 2019a

Rice has declined in importance in diets, household expenditures, and the agroeconomy, but remained the focus of agriculture spending through market interventions and distortionary instruments

This has produced limited success...

Paddy output and yields have not been highly responsive to supportive policies

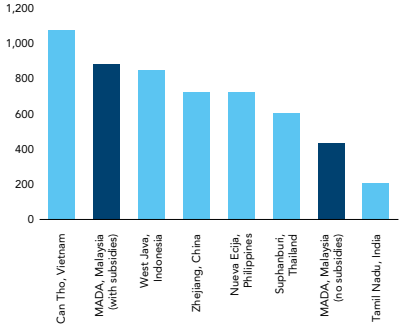
Paddy Production and Yields in Granary and Non-granary Areas in Millions of Tons and Tons Per Hectare, 1980-2018



Source: Malaysia Department of Agriculture and estimates for paddy productivity

Malaysian paddy production is far less profitable when subsidies are not factored in

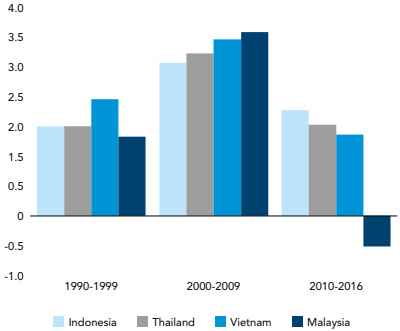
Profitability of Paddy Production in Key Rice Growing Areas in Seven Countries, 2014, US$ Per Hectare



Source: Omar, Shaharudin, and Tumin 2019

Malaysia's agricultural total factor productivity may be running out of steam

Agriculture Total Factor Productivity, Growth by Decade, in Selected Countries,1990-2016, Percentage

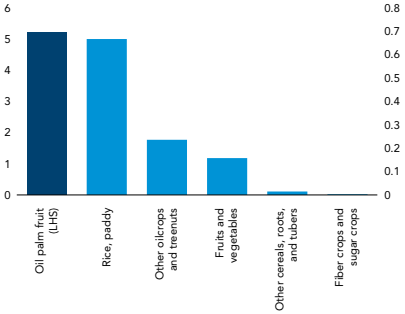


Source: USDA 2020

...but also some policy "blind spots" which includes insufficient focus on diversification...

Malaysia has remained focused on producing few crops...

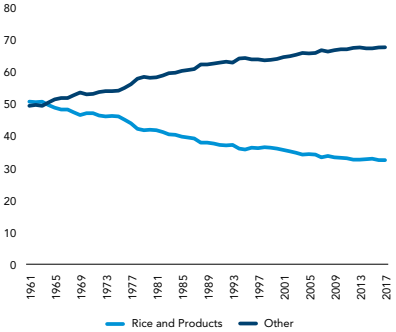
Malaysia's Crop Mix, 2018, Millions of Hectares



Source: FAOSTAT 2020

...while what it and the region consume has greatly diversified

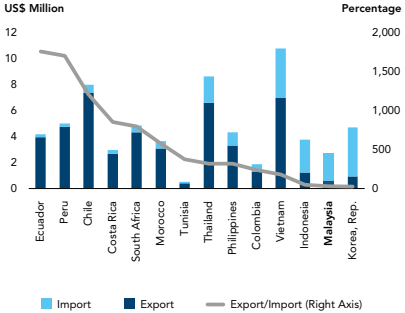
Food Supply in 15 Eastern and Southeast Asian Countries, 1961-2017, Percentage



Source: FAOSTAT 2020

Malaysia's exports of fruits and vegetables have not increased commensurately with imports as much as in other countries

Fruit and Vegetable Trade in Selected Countries, 2019

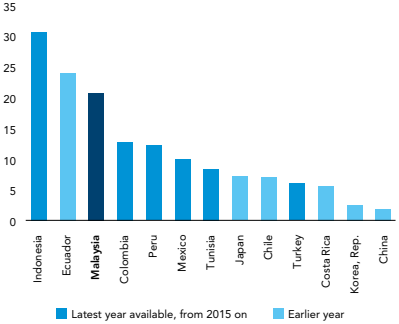


Source: Comtrade 2020

...and insufficient focus on nutritional security and healthy diets

Hunger is nearly a problem of the past, but hidden hunger is not

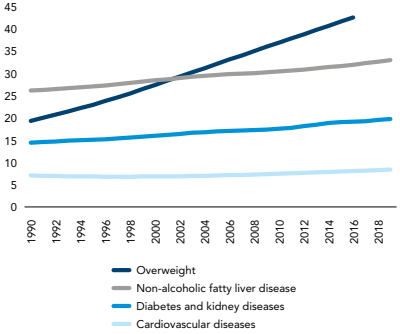
Stunting in Selected Countries, Percentage of Children Under 5, Latest Year Available



Source: HNP 2020, based on latest available data

Malaysia can still take preventive action to curb the progression of noncommunicable diseases...

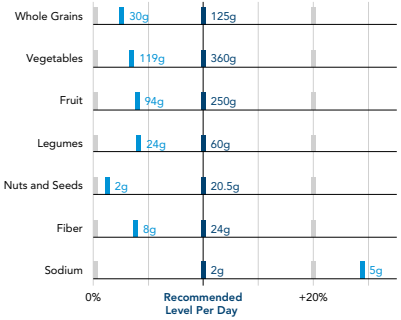
Prevalence of Selected NCDs in Malaysian Adults Age 20+, 1990-2019, Percentage



Source: GBD 2020 and HNP 2020

Malaysian consumption patterns deviate significantly from dietary recommendations

Consumption of Selected Food Groups and Components, 2017



Source: GBD 2018
Note: The "recommended level" label is the midpoint of the theoretical minimum risk exposure level (TMREL) range.

Malaysia's agrofood sector could do so much more



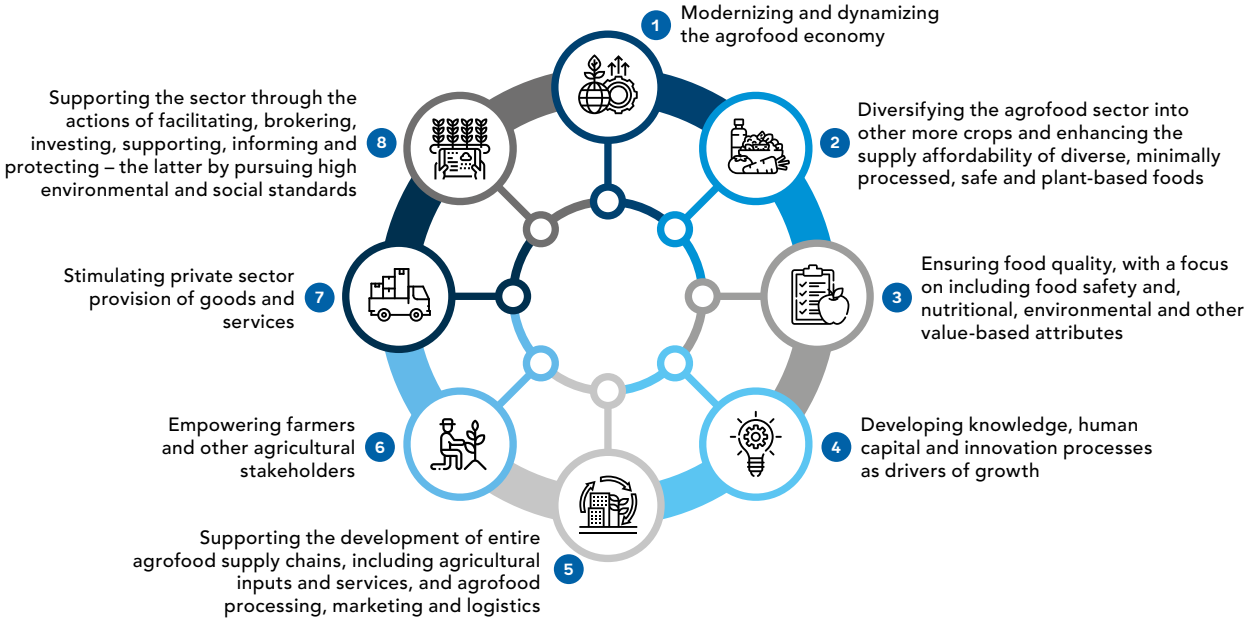






Reform opportunities: RMK12 and Cabinet Committee on National Food Security Policy

The agricultural sector's potential should be clearly laid out in the RMK12



Source: World Bank staff illustration

Agrofood policy: toward new aims and means

Key considerations for the Cabinet Committee on National Food Security Policy

Rice and Other Food Crops

"Right-sizing" rice production in agricultural policy and focusing more on other crops and their entire supply chains will enable Malaysia to supply a wider range of healthy and sustainable food more affordably while boosting access to them by supporting higher agricultural incomes

Availability and Affordability

Evidence, including that emerging from the COVID-19 crisis, suggests that food insecurity often related more to problems of food quality, affordability, and choices than to shortages of availability

Longstanding Malnutrition and Emerging Malnutrition

Food security policy also needs to take a wider range of dietary outcomes into consideration (both nutritional and chronic diseases) in order to prevent changing diets from harming Malaysian productivity and lives

Rural and Urban

In the context of COVID-19, the particular challenges of cities have highlighted the need for applying a more urban lens to food security policy, including in defining supportive agricultural policies

Source: World Bank staff illustration

BOX 9

Even incremental reforms of rice policy could be beneficial to farmers

An on-going World Bank analysis suggests that even incremental reforms to Malaysia's rice policy could be beneficial to farmers. The analysis points to the feasibility of incremental reforms to rice sector protections and subsidies to better align Malaysia's provision of farm support with international best practices. One such reform would involve replacing farm subsidies that are currently based on how much farmers produce (which greatly influence farmer decision making), with direct payments of equal value to incentivize them to become more responsive to markets and better agroecosystem stewards. Subsidies of this nature could also subsume rice fertilizer subsidies. These subsidies are not only poorly targeted and wasteful, but also support an industry whose current dysfunction is directly harmful to farm operations (with exceedingly long wait times to obtain a product of poor quality).

Similarly, even a partial liberalization of rice imports and prices, involving the lowering of import restrictions and the dismantling of price floors and ceilings, would leave farmers better off. In parallel, lifting restrictions on the production, marketing, and export of expensive fragrant rice varieties, far from jeopardizing rice stocks or food security, could also provide a means for some farmers in Sabah and Sarawak to enhance their livelihoods and food access by deriving value from the wealth of fragrant rice varieties that are unique to this part of the country and that have potentially high value on global markets. Meanwhile, given that Malaysia's rice supplies are robust, it seems that greater stockpiling at this point is not necessary to enhance food security.

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