

BUFF/22/9

March 31, 2022

Statement by the Staff Representative on Malaysia
Executive Board Meeting
April 6, 2022

This staff statement provides updates on developments since the staff report was issued on March 7 (SM/22/53), including the impact of the Ukraine-Russia conflict and the evolution of the pandemic. The thrust of the staff appraisal remains valid.

1. **While downside risks to the outlook for the Malaysian economy have been amplified by the conflict in Ukraine, the eventual impact on the pace of the recovery is expected to be moderate.** The economy has limited direct exposures to Russia and Ukraine, with bilateral goods trade with the two countries accounting for about ½ percent of GDP in 2021 and tourism flows less than 1 percent of total flows. The resource-rich Malaysian economy could benefit from the positive terms-of-trade effects driven by higher oil prices. However, this could be weighed down by the negative spillovers from the conflict through the impact of higher food and energy prices on domestic inflation, disruptions to supply chains, and weaker partner country demand. The second-round impact on domestic inflation will be mitigated by the still-sizeable slack in the economy, with inflation expectations well anchored. On March 10, the Minister of Finance announced that fuel subsidies could reach 1.7 percent of GDP in 2022 (more than double the level in 2021) if oil prices remain above \$100 per barrel for a prolonged period. The additional subsidies will be financed by higher oil revenues with the net fiscal impact either broadly neutral or slightly positive. Staff has revised the 2022 growth forecast downward to 5.6 percent from 5.7 percent in the staff report. Inflation is now projected to increase from 2.5 to 3 percent in 2022. The slightly revised baseline is broadly consistent with the main thrust of the near-term outlook and the supporting policies that were discussed with the authorities.

2. **Reflecting the expected moderate macroeconomic impact of the conflict, financial market responses have been muted.** The Malaysian Ringgit has been relatively stable and remained at levels similar to those recorded before the invasion on February 24. While Malaysian markets are pricing in a slightly higher short-term inflation risks, spot and, more importantly, forward long-term bond yields are broadly unchanged, suggesting transitory inflation pricing. The stock market held up supported by strong performance of commodity-related stocks. A prolonged conflict could lead to major spike in global risk aversion and tighten financial conditions in Malaysia, as in other EMs, and compound the spillovers. Nevertheless, the resilience of Malaysia's financial sector, supported by strong buffers in the banking sector that were built pre-pandemic, would continue to underpin financial stability.

3. **On the pandemic front, Malaysia is transitioning to an endemic phase of COVID-19 and is preparing to substantially relax border restrictions effective April 1.** Even with the increased case numbers caused recently by the Omicron variant, ICU utilization and fatality rates

remain relatively low, and well below the peak in 2021, supported by the government's impressive vaccination and booster program. With the improvement in pandemic risk factors, Malaysia is moving toward an endemic phase, enabling businesses to operate at full capacity. Effective April 1, fully vaccinated travelers will be able to travel without quarantine, while a 5-day quarantine will be required for those who are not fully vaccinated. The planned reopening of the borders is expected to provide a boost for the tourism industry and support the ongoing economic recovery.