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April 4, 2022

**Statement by Mr. Bhalla and Mr. Singh on Malaysia
(Preliminary)
Executive Board Meeting
April 6, 2022**

1. We thank the staff for a well-written report and Ms. Lim, Mr. Mochtar, and Mr. Azlan Ariff for their informative buff statement.
2. It is encouraging to note that the Malaysian economy has rebounded from the pandemic with the authorities expecting 5½-6½ percent GDP growth in 2022, though, as elsewhere in EMEs, the **concerns remain about the uneven labour market recovery which exacerbates income inequality and represents considerable risks to SMEs, low-skilled workers, and those in the informal sector**. While all the components of aggregate demand seem to have recovered, investment demand continues to remain in contraction mode, which may impede future capacity. *It may be instructive to understand whether the continued contraction is mainly led by the excess capacity in the economy or the indebtedness of the corporate sector and perceived risk in locking in new investments are leading to this contraction.*
3. The staff believes that fiscal adjustment should start once the output gap is sufficiently closed and be primarily revenue-based to help rebuild the buffers and enable the adoption of measures that are important for external rebalancing. However, the authorities believe that improvement in the economy's cyclical position in 2022 suggests the need to start a cautious fiscal adjustment path to ensure sustainability. **We are sympathetic to the views of the authorities on fiscal policy choices as fiscal sustainability needs to be seen in the context of the additional fiscal risk arising from the contingent liabilities of the government which remain high at 20 percent of GDP.**

4. On the monetary policy front, while the staff believes that the accommodative monetary policy stance is appropriate, authorities consider that transition to policy normalization would be guided by a sustained narrowing, but not necessarily closing, of the output gap. *It may be useful to understand if a high producer price inflation remains a major concern for the authorities while calibrating their monetary policy stance.* We agree that in case of an adverse shock, the exchange rate should remain the main shock absorber. However, like other Asian EMEs, Malaysia faces high volatility in capital inflows and tightening of financial conditions by advanced economy central banks may necessitate the reversal of the monetary easing cycle of the EMEs. These concerns assume greater importance for those economies where short-term capital flows remain significant.

5. We agree that the continued **targeted support to the corporate sector would help limit scarring** and shore up viable firms through the recovery. Support measures may be targeted toward solvent SMEs, which make up a large part of Malaysian firms and have been disproportionately impacted by the pandemic shock.

6. We note that trade has been a powerful driver of growth and poverty alleviation in Malaysia, but non-tariff barriers have remained high. The staff technical analysis indicates that while and pandemic would adversely impact trade and GVC patterns in the medium term, a reduction in non-tariff barriers could boost growth, productivity, and investment, mitigating some of the pandemic-related losses. Thus, **we suggest increasing focus on achieving trade competitiveness in the post-pandemic period.**

With these comments, we wish the authorities all the very best in their endeavors.