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February 18, 2021

Statement by Ms. Levonian, Mr. O'Brolchain, and Ms. Smith on Malaysia
(Preliminary)
Executive Board Meeting
February 22, 2021

We thank staff for their informative reports, as well as Ms. Mahasandana and Mr. Mahyuddin for their helpful buff statement.

Following robust growth in 2019, COVID-19 has led to a sharp contraction in Malaysia's economy. The authorities' coordinated policy response has mitigated the pandemic's impact, but downside risks remain. We largely concur with staff's assessment and recommendations and wish to highlight the following for emphasis.

We support the authorities' use of fiscal policy to help mitigate the effect of the virus and welcome a return to fiscal consolidation when economic conditions improve. Given the authorities' reduced fiscal space, we agree with staff that monetary measures will be necessary to provide additional support in the case of an adverse scenario. The authorities should also resume work with the Fund on the medium-term revenue strategy, with a view to implement revenue-enhancing measures as soon as the economy recovers. This, together with prioritized spending should help to rebuild buffers.

The improvement in social indicators, including the declines in absolute poverty and inequality, are commendable. We note however, that inequality remains higher than other countries in the region, and that unemployment continues to be elevated among women and youth. The budgeted spending on social and labor market programs for 2021 should be beneficial in this respect. We also support the planned review of the social protection system and associated reforms to improve efficiency and coverage.

The authorities' monetary, exchange rate and financial market measures are appropriate. The financial system's strong position prior to the pandemic, along with the Bank Negara Malaysia's (BNM) proactive policy adjustments—including Bank rate reductions, loan moratoria and restructuring, as well as allowing the exchange rate to depreciate as needed—bolstered liquidity and stability. Nonetheless, heightened surveillance and guidance will be imperative as the pandemic evolves, especially in the context of asset quality vulnerabilities amid elevated household and corporate debt.

We note positively Malaysia's strong financial penetration indicators relative to peers, as well as the increase in digital payments following the pandemic. Moreover, innovations to improve inclusion, such as digital banks, are noted with interest. The authorities should ensure that know-your-customer and AML/CFT safeguards are in place to minimize fraudulent activity and protect financial sector integrity.

We applaud the authorities on their work to strengthen the framework for assessing climate change risks in the financial sector. The approach and lessons learnt should be useful for other countries susceptible to climate related shocks.

Efforts to deepen foreign exchange markets as well as financial market reform should continue. The BNM's measures to enhance the FX market, and contain excessive volatility, help to support monetary and financial stability**.** We welcome the BNM's request for Fund assistance to analyze the role of the exchange rate in Malaysia's economy and explore further options to deepen FX markets. Continued dialog and consultation should support the prudent easing of Capital Flow Measures (CFM) over time.

We support the initiatives outlined in the 12th Malaysia Plan, to strengthen healthcare, education, and the digital infrastructure, in addition to greening the economy. The authorities should also stay the course with reforms to improve governance and contain corruption in a bid to boost investor confidence.