MALAYSIA

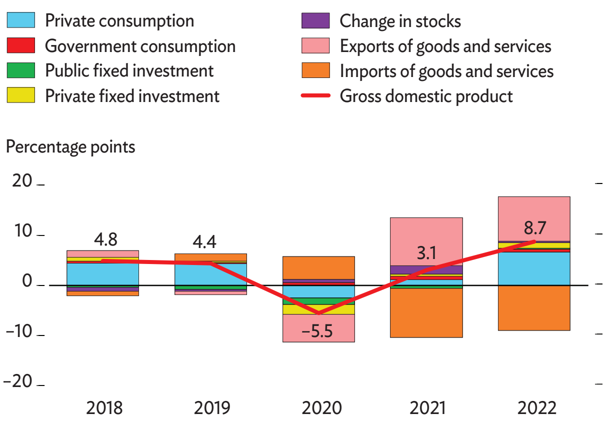
Growth exceeded expectations in 2022, buoyed by strong domestic consumption and a rebound in services as borders reopened and economic activity normalized. Inflation remained broadly muted, dampened by government subsidies and price controls. A less accommodative monetary stance was adopted in response to higher global interest rates. Growth is expected to moderate, and inflation to decelerate, in 2023 and 2024, mainly tracking changes in the global environment. Malaysia should promote gender-inclusive policies to boost women's participation in the labor market.

Economic Performance

Growth outperformed expectations. Malaysia maintained a performance that was better than expected, growing by 7.0% year on year in the fourth quarter (Q4) to round off 2022 with growth at 8.7%, significantly higher than 3.1% in 2021 (Figure 2.26.1). Robust growth was driven mainly by strong domestic consumption as markets normalized and labor market conditions improved.

Figure 2.26.1 Demand-Side Contributions to Growth

Domestic consumption boosted growth, supported by the reopening of borders.



Sources: Bank Negara Malaysia. 2023. *Monthly Highlights and Statistics*; Haver Analytics.

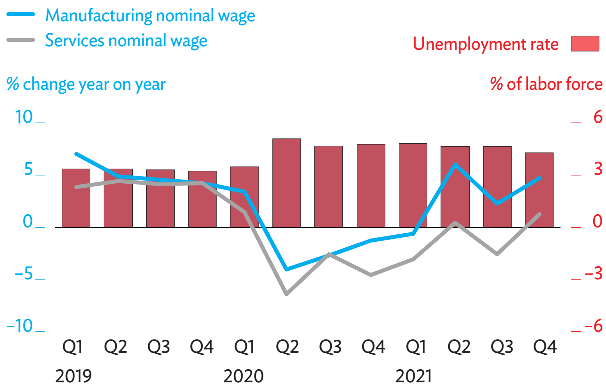
All demand components contributed to strong growth, with private consumption at the forefront. Private consumption accelerated from 1.9% growth in 2021 to double-digit growth at 11.3% in 2022, sustained by higher employment and incomes. The unemployment rate improved from 4.3% at the end of 2021 to 3.6% a year later. Other spurs to spending were several policy measures, notably an increase in the monthly minimum wage from RM1,200 to RM1,500, and Bantuan Keluarga Malaysia, a financial package for low-income households (Figure 2.26.2). Growth in public consumption moderated from 5.3% the previous year to 3.9%. Public consumption was supported by COVID-19 expenditure such as vaccine procurement at the start of the year and, later, increased spending on supplies and services.

Public investment recovered after contracting by 11.3% in 2021 to grow by 5.3% in 2022. The main drivers of growth were increased capital spending by the general government and public corporations in oil, gas, and telecommunications. Private investment expanded by 7.2% in 2022 from 2.6% growth last year. Services and manufacturing alike saw increases in capital spending. Firms expanded capacity in response to continued improvement in demand, which fueled

This chapter was written by James Villafuerte of the Southeast Asia Department (SERD), ADB, Manila, and Mae Hyacinth Kiocho, SERD consultant.

Figure 2.26.2 Labor Market Indicators

Labor market conditions improved with the revival of economic operations and social activities.



Q = quarter.

Source: Haver Analytics.

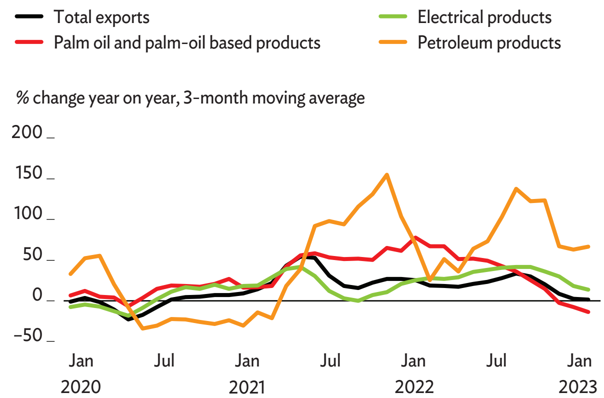
robust investment in machinery and equipment. A shift toward automation and digitalization saw manufacturers invest in information and communication technology.

Trade performance started to weaken in 2022, reflecting softer external demand. Growth in exports of goods and services slowed from 23.9% in Q3 2022 to 9.6% in Q4 as global demand weakened. Despite slowing export growth in recent months, growth in the whole year was, at 12.8%, not much lower than 15.4% in 2021. Exports of electrical and electronic products and of petroleum products had increased before Q4 2022 in line with higher commodity prices, especially for petroleum, which pushed up export value. Growth in all three key export commodities then slowed by the end of 2022 (Figure 2.26.3). Meanwhile, import growth slowed from the previous year's 17.7% to 14.2%, the increase fueled by demand for imported goods buoyed by accelerated growth in private consumption. Capital imports soared on investment activity and firms building inventory. Imports outpaced exports, narrowing the trade surplus to the equivalent of 5.4% of GDP.

A resurgence of other economic activity sparked robust growth in services. Services performed strongly as growth surged from a mere 1.9% in 2021 to 10.9% (Figure 2.26.4). With the reopening of the economy and the normalization of activity, consumers returned to drive robust growth in retail and leisure businesses. Business improved as well in air passenger traffic, tourist arrivals, and property transactions.

Figure 2.26.3 Exports of Key Commodities

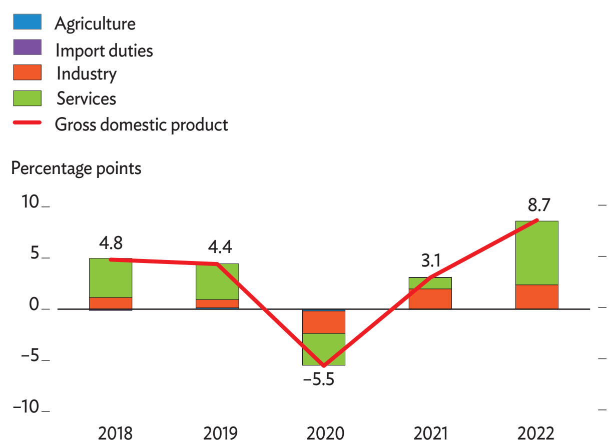
Growth of exports slowed in line with weakening global demand.



Source: Haver Analytics.

Figure 2.26.4 Supply-Side Contributions to Growth

Services expanded substantially as consumer and leisure activities gained momentum.



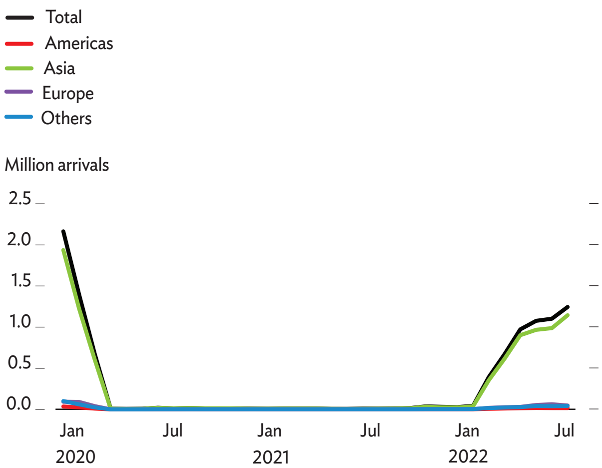
Sources: Bank Negara Malaysia. 2023. *Monthly Highlights and Statistics*; Haver Analytics.

Tourist arrivals soared from fewer than 80,000 in January–September 2021 to 5.6 million a year later (Figure 2.26.5). Areas leading growth in services were accommodation at 125.1% growth, motor vehicle sales at 40.0%, transport and storage 30.8%, and real estate 28.5%.

Manufacturing remained resilient but showed signs of slowing down. From 13.2% year on year in Q3 2022, growth in manufacturing decelerated to 3.9% in Q4 with slower semiconductor sales globally. In the whole year, manufacturing growth slowed from 9.5% in 2021 to 8.1%, with little difference between

Figure 2.26.5 Tourist Arrivals

Tourist arrivals started to pick up as borders reopened in April 2022.

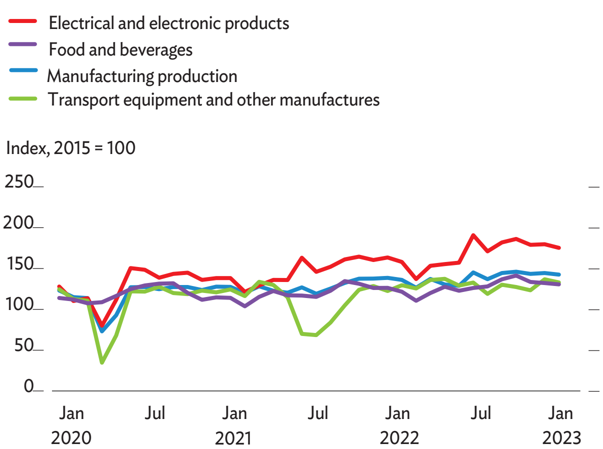


Source: Haver Analytics.

export-oriented and domestic industry. Despite the slowdown in Q4 2022, resilient demand for electrical and electronic goods increased the segment's industrial production index from 147.7 in 2021 to 168.8 in 2022. Meanwhile, higher consumer spending accelerated growth in consumer goods, as reflected by a rise in the industrial production index of transport equipment and other manufactures from 110.1 in 2021 to 130.0 in 2022 (Figure 2.26.6).

Figure 2.26.6 Manufacturing Production Index

Manufacturing continued to expand but at a more moderate pace.

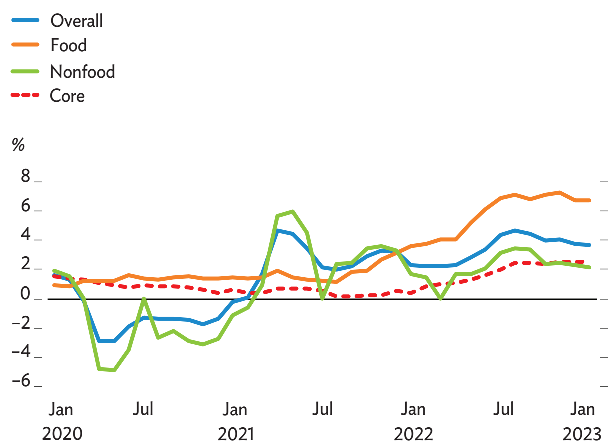


Source: Haver Analytics.

Robust demand, supply disruption, and cost-push factors sustained high inflation. Inflation remained elevated in Q3 2022, reaching 4.7% year on year in August 2022. This reflected a base effect from the expiration of electricity bill discounts under the People's Protection and Economic Recovery Package implemented from July to September 2021. Inflation eased to 3.8% in December, but 2022 still posted a higher average rate of 3.4%, up from 2.5% in 2021. The rise in inflation was driven mainly by price increases for food at 5.8%, transportation 4.7%, and restaurants and hotels 5.0% (Figure 2.26.7). Factors that drove inflation in 2022 were continued demand improvement despite a high-cost environment from supply disruption and commodity price increases caused by geopolitical tensions, lockdowns in the People's Republic of China (PRC), and adverse weather in key food-exporting countries, as well as a weakening local currency against the US dollar. The government contained inflation and its impact on households through price controls and subsidies, with the subsidy bill for the year reaching approximately RM80 billion, the highest ever recorded.

Figure 2.26.7 Monthly Inflation

Inflationary pressures drove up food prices in particular.

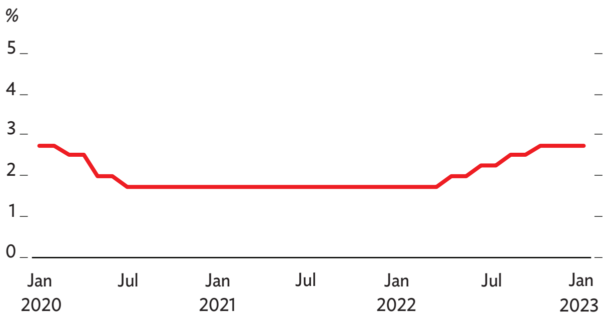


Source: Haver Analytics.

The steep increase in inflation prompted less accommodative monetary policy. Bank Negara Malaysia, the central bank, raised its overnight policy rate by 100 basis points, from 1.75% at the end of 2021 to 2.75% a year later (Figure 2.26.8). The central bank believed that, despite the increase in the policy rate, its monetary stance remained supportive of recovery and growth.

Figure 2.26.8 Policy Rate

Elevated cost pressures prompted a less accommodative monetary stance.



Source: Haver Analytics.

Fiscal and external positions remained stable with moderate debt and depreciation of the local currency. With a higher surplus in the goods account and a reduced deficit in services with increased travel and transport receipts from a pick up of tourist arrivals, the current account surplus expanded further in Q4 2022. However, in the whole year, the current account surplus declined from the equivalent of 3.8% of GDP in 2021 to 2.6% in 2022. Growth in government revenue rose from 3.9% in 2021 to 25.9% as, similarly, operating expenditure rose from 3.1% to 26.4%. Net development expenditure, on the other hand, posted slower growth, falling from 26.3% the previous year to 10.9%. The fiscal deficit widened slightly from RM98.7 billion in 2021 to RM99.6 billion. The weakening of the Malaysian ringgit against the US dollar and increased intragroup interbank borrowings edged external debt higher to RM1,169.4 billion, equal to 67.0% of GDP, at the end of Q3 2022. By the end of December 2022, external debt had eased to RM1,144.0 billion, or 64.0% of GDP. Higher global interest rates caused the ringgit to depreciate against the US dollar by an average of 6.2% in 2022. International reserves stood at $114.6 billion in December 2022, enough to cover 5.2 months of imports of goods and services.

Economic Prospects

Economic performance in 2023 will depend on the external environment. Factors include spillover from the reopening of the PRC, government policy support, and developments in the electronics industry. The global economic slowdown, persistent inflation, and continuing rate hikes by the US Federal Reserve diminish prospects for the year. On the upside, impacts from such downside risks can be countered by stronger growth in the reopened PRC, recovery in tourism, and continued government support to boost domestic consumption and tame inflation. In 2023, GDP is expected to grow at a moderate pace of 4.7% before accelerating to 4.9% in 2024 (Table 2.26.1 and Figure 2.26.9).

Resilient consumer spending will support domestic consumption. Private consumption is anticipated to remain the primary driver of growth, increasing by an average of 5.6% in 2023 and 2024. Consumer sentiment has brightened on improved expectations for income and employment. However, consumers remain

Table 2.26.1 Selected Economic Indicators, %

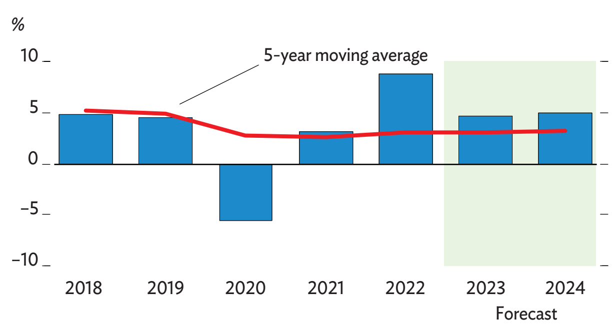
Moderate growth is expected in 2023 and 2024, along with relatively stable inflation.

	2021	2022	2023	2024
GDP growth	3.1	8.7	4.7	4.9
Inflation	2.5	3.4	3.1	2.8

GDP = gross domestic product.
Sources: Department of Statistics Malaysia; Asian Development Bank estimates.

Figure 2.26.9 GDP Growth

The economy is projected to grow moderately in 2023 and 2024.



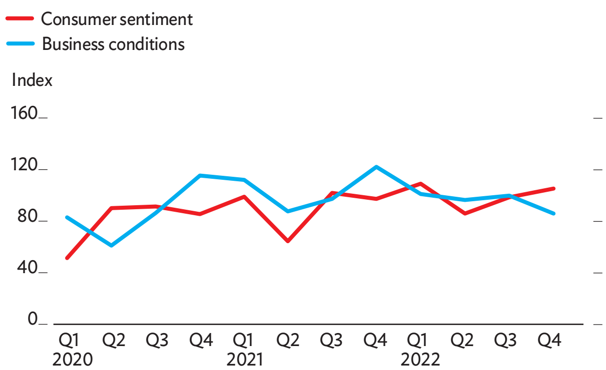
Source: *Asian Development Outlook* database.

cautious about the possibility of a future downturn and further price developments that would likely affect the cost of living (Figure 2.26.10).

The perception of business conditions could dim with the growth slowdown. Meanwhile, business prospects are worsening, with firms seeing reduced orders, both domestic and external. The business sentiment index remained below the 100 threshold, declining from 99.8 in Q3 2022 to 85.9 in Q4 (Figure 2.26.10).

Figure 2.26.10 Consumer and Business Sentiment

Consumer expectations continued to be optimistic, while business prospects became gloomy.



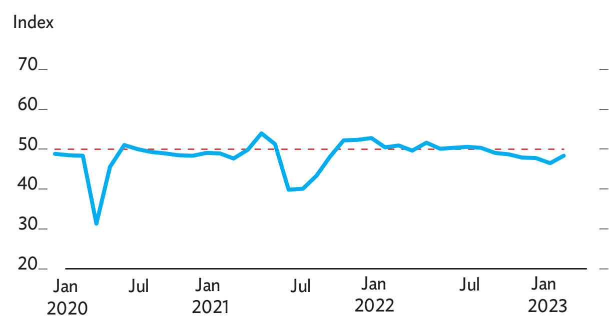
Q = quarter.
Source: Haver Analytics.

Investment could still expand, however, with sustained digitalization and government reform to improve the business environment. The outlook for investment is projected to be positive as a technology-driven surge in approved foreign direct investment is expected to continue under automation and digitalization initiatives and the rollout of 5G infrastructure. The government aims to encourage investment in high technology and restructure investment incentives in key industries such as electrical and electronic goods and aerospace. Further, the government strives to reform the public sector to inspire confidence in it and improve governance, which can enhance the investment environment.

Services will continue to drive growth, with manufacturing hampered by weak external demand and a grim global outlook for tech. On the supply side, services will take the lead as tourist arrivals increase and economic activity returns to pre-pandemic conditions, further enlivening leisure and consumer services. Manufacturing, on the other hand, faces challenges as exports will likely to be crimped by reduced global demand and changes in the environment for semiconductors. The manufacturing purchasing managers' index declined further from 47.8 in December 2022 to 46.5 in January 2023 as demand and production slowed in line with economic weaknesses both at home and abroad (Figure 2.26.11). Semiconductor sales are challenged by a change in industry dynamics, with the US, Europe, Japan, and the Republic of Korea pursuing policies to boost local production and thereby strengthen their national supply chain security in response to supply disruption and geopolitical tensions between the US and the PRC.

Figure 2.26.11 Manufacturing Purchasing Managers' Index

The manufacturing index has been contractionary for the past 6 months.



Note: A purchasing managers' index reading <50 signals deterioration, >50 improvement.
Source: Haver Analytics.

The global slowdown may bring slightly lower inflation, but prices could surprise on the upside if commodity prices soar again. The inflation rate will likely decelerate with the weakening of domestic and global demand amid continuing efforts by the government to contain a rising cost of living and strengthen the ringgit, and by recovery in the global supply chain. Any increase in inflation would depend on changes to domestic policies on subsidies and price controls and developments in global commodity prices. Inflation is projected to be lower, at 3.1% in 2023 and 2.8% in 2024.

The government plans to continue to support growth and domestic consumption and strengthen fiscal sustainability. It is taking an expansionary stance to support economic growth. The 2023 budget is RM386.1 billion, larger by 16.3% over last year, and includes an increase in development expenditure from RM71.6 billion to RM97.0 billion to fund programs to eradicate poverty and improve public infrastructure and rural facilities. Measures to reduce the cost of living are maintained by the government with an allocation of RM64 billion provided through subsidies, assistance, incentives, and price controls on essential goods. The national debt is forecasted to reach about RM1.2 trillion and thus exceed 60% of GDP. With the high debt burden, fiscal sustainability is at the forefront of government objectives to manage debt by tamping down on new loans and target fiscal deficit reduction from the equivalent of 5.6% of GDP last year to 5.0%.

Monetary policy could still tighten in 2023 but not as much as in 2022. In adjusting monetary policy, the central bank aims to balance managing inflation and supporting economic growth. Any change in monetary policy has been put on pause. However, there is a possibility of an increase by 25 basis points in the year, but it depends on global commodity price movements and on domestic policy measures such as fuel subsidies and price controls.

Risks tilt to the downside. Manufacturing exports are likely to contract with the slowdown in global demand. The downward outlook in the tech cycle means higher risks for the electrical and electronics industry, and worsening geopolitical tensions could disrupt supply and further raise trade costs. On the other hand, the outlook could improve with higher tourist arrivals from the PRC and higher revenue from elevated prices for oil and other commodities.

Policy Challenge—Promoting Inclusive Gender Policies

Dealing with gender equality is a major challenge for Malaysia. Gender disparities have narrowed in recent years, but Malaysian women could still contribute more to the economy. Disparities in the labor market and housework restrict the occupational choices of Malaysian women and lower their expected wages. Malaysia has made considerable progress in advancing women's education and health, but gender disparities in the labor market remain challenging. Women comprise 48.4% of Malaysia's working-age population, but only 55.5% of them participated in the labor market in 2021, their share in the labor force only 39%. While female labor force participation has improved somewhat from 46.8% in 2010, it remains lower than in Malaysia's neighbors in Southeast Asia and in countries of similar income status. Women dominate among those outside the labor force at 69%, and most cited housework as an important reason for not seeking work. Moreover, gender segregation in occupations discourages women in the more high-skilled ones; they are often employed instead in semiskilled occupations in services and as clerical workers.

Women's mean monthly earnings are significantly lower than men's in all major occupations. Female managers earn only 77.4% of what male managers earn. In services, sales, and clerical work, where most women are employed, their salaries are only 81.3%–81.5% of what men in the same occupation receive. The smallest earnings difference is in crafts and related work, at 4.3%, and in low-skilled occupations, at 6.4%. Increasing female participation in the labor market, particularly in highly productive jobs, can help Malaysia fulfill its development potential. Malaysia is expected to become an aging society by 2030. With its declining total fertility rate, the working-age share of the population is likely to shrink in the coming years. Policy makers should address persistent barriers that prevent women in Malaysia from joining the workforce and identify the most effective instruments to encourage women to take part.