INTERNATIONAL MONETARY FUND

IMF Country Report No. 24/73

MALAYSIA

March 2024

2024 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; STAFF STATEMENT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR MALAYSIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2024 Article IV consultation with Malaysia, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its February 21, 2024 consideration of the staff report that concluded the Article IV consultation with Malaysia.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on February 21, 2024, following discussions that ended on December 14, 2024, with the officials of Malaysia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on February 2, 2024.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for Malaysia.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

PRESS RELEASE

PR 24/78

IMF Executive Board Concludes 2024 Article IV Consultation with Malaysia

FOR IMMEDIATE RELEASE

Washington, DC – **March 10, 2024:** On February 21, 2024, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Malaysia.

Malaysia's growth momentum is slowing, albeit from a high base in 2022. Advanced estimates indicate 3.4 percent growth for 2023Q4, down from 8.7 percent in 2022. Growth is estimated at about 4 percent in 2023, driven by robust domestic demand, as exports weakened markedly due to the economic slowdown in major trading partners.[2] Disinflation is taking hold, with average inflation falling to 2.5 percent in 2023, down from 3.4 percent in 2022. Malaysia's strong macroeconomic policy frameworks, including a track record of fiscal prudence and a credible monetary policy framework, have served the country well and have become more important as it undergoes important structural reforms. A history of costly and untargeted spending on subsidies is coming to an end.

Macro policies have appropriately tightened. Bank Negara Malaysia (BNM) had increased the overnight policy rate (OPR) five times since May 2022 by a total of 125 bps to its pre-pandemic level of 3.0 percent. The OPR remained unchanged since May 2023 with the monetary policy stance currently broadly neutral. The 2023 Budget deficit target is expected to be met. The 2024 Budget appropriately charts the near-term consolidation path, targeting a decline in the overall deficit from 5 percent of GDP in 2023 to 4.3 percent in 2024, and down to less than 3 percent of GDP by 2026.

Resilient domestically driven growth and upside risks to inflation define the near-term outlook. Growth is projected to slightly accelerate to 4.3 percent in 2024, supported by resilient private consumption and investment and a rebound in public spending. Inflation is projected to pick up to 2.9 percent in 2024, pending uncertainty around subsidy reform. Over the medium term, the current account surplus is expected to widen, as tourism recovers and improves the services balance.

Executive Board Assessment[3]

Executive Directors welcomed Malaysia's economic resilience, underpinned by strong fundamentals and the authorities' sound policymaking. Noting downside risks to the growth outlook and upside risks to inflation, Directors agreed that near-term macroeconomic policies

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] The data utilized in this report for staff analysis are as of January 30, 2024, unless otherwise noted. The official preliminary GDP figures for the full year are scheduled to be released on February 16, 2024.

[3] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

should focus on preserving price stability and rebuilding buffers, while structural reforms should support medium-term growth and the path to high-income status.

Directors welcomed the recent enactment of the Public Finance and Fiscal Responsibility Act 2023 and the authorities' planned fiscal consolidation, which would help rebuild buffers. To support the consolidation path as well as the country's development and social needs, Directors called for credible and durable revenue mobilization measures and for spending prioritization. In this context, they encouraged the authorities to continue implementing the subsidy reform and to consider reintroducing the Goods and Services Tax, which can help finance pro-poor spending, thereby offsetting its regressivity effects.

Directors generally agreed that the central bank's broadly neutral, data-dependent monetary policy stance will help safeguard price stability. They cautioned against prematurely cutting policy rates, noting upside risks to inflation. Directors welcomed the central bank's measures to further develop FX markets and concurred that exchange rate flexibility and reserve adequacy should be preserved.

Directors welcomed the financial sector's soundness and the authorities' commitment to safeguard financial stability. They encouraged the authorities to continue monitoring highly leveraged households and small firms, and welcomed the updates to stress-test design to better capture emerging risks. Directors also encouraged the authorities to consider expanding, as needed, the macroprudential toolkit in a preventive manner. They welcomed the strengthening of AML/CFT frameworks and called for continued efforts on this front.

Directors commended the authorities' appropriately focused and concerted structural reform agenda and called for its timely implementation. They recommended focusing on reforms to improve labor market outcomes and increase incomes, which would also contribute to external rebalancing. Directors emphasized the importance of promoting the green transition and digitalization—including carefully leveraging the benefits of Artificial Intelligence—and of enhancing governance and anti-corruption frameworks. They underscored the importance of preserving the sustainability of the pension system, noting the authorities' initiatives on this front.

Table 1. Malaysia: Selected Economic and Financial Indicators, 2020-26

Nominal GDP (2022): US$407.0 billion

GDP per capita (2022, current prices): US$12,466

Unemployment rate (2022, period average): 3.8 percent

Population (2022): 32.7 million

Poverty rate (2019, national poverty line): 0.2 percent

Adult literacy rate (2019): 95.0 percent

Main domestic goods exports (share of total domestic exports, 2022): Machinery and Transport Equipment (43.4 percent), Miscellaneous Manufactured Articles (10.5 percent), and Manufactured Goods (8.9 percent).

				Proj.			
	2020	2021	2022	2023 Est. 1/	2024	2025	2026
Real GDP (percent change)	-5.5	3.3	8.7	4.0	4.3	4.4	4.4
Total domestic demand	-4.8	3.8	9.3	4.3	4.0	4.2	4.2
Consumption	-2.6	2.7	9.9	5.6	5.0	3.9	4.1
Private consumption	-3.9	1.9	11.2	7.5	6.1	4.6	4.7
Public consumption	4.1	6.4	4.5	-3.3	-0.8	0.0	0.8
Private investment	-11.9	2.7	7.2	5.6	6.4	6.0	5.7
Public gross fixed capital formation	-21.2	-11.1	5.3	-17.5	-8.7	1.6	-0.7
Net exports (contribution to growth, percentage points)	-1.0	-0.3	-0.1	-0.1	0.5	0.5	0.4
Saving and investment (in percent of GDP)							
Gross domestic investment	19.7	22.1	23.5	24.0	23.5	24.0	24.0
Gross national saving	23.8	26.0	26.6	26.4	26.3	26.8	26.9
Fiscal sector (in percent of GDP) 2/							
Federal government overall balance	-6.2	-6.4	-5.6	-5.0	-4.2	-4.2	-4.2
Revenue	15.9	15.1	16.4	15.9	14.9	14.5	14.1
Expenditure and net lending	22.0	21.5	22.0	20.9	19.2	18.8	18.3
Tax refunds (Arrears)							
Federal government non-oil primary balance	-5.0	-4.4	-6.2	-6.2	-4.8	-4.2	-3.6
Consolidated public sector overall balance 3/	-7.3	-8.3	-6.7	-7.9	-5.9	-5.8	-5.6
General government debt 3/	67.7	69.2	65.6	66.8	66.6	66.5	66.8
Of which: federal government debt	62.0	63.3	60.3	61.5	61.2	61.2	61.5
Inflation and unemployment (annual average, in percent)							
CPI inflation	-1.1	2.5	3.4	2.5	2.9	2.5	2.2
CPI inflation (excluding food and energy)	1.1	0.7	3.0	3.0	3.1	2.0	2.0
Unemployment rate	4.5	4.7	3.8	3.6	3.5	3.5	3.5
Macrofinancial variables (end of period)							
Broad money (percentage change) 4/	4.9	5.6	4.0	6.6	7.9	7.5	6.7
Credit to private sector (percentage change) 4/	4.0	3.8	3.0	6.6	7.9	7.5	6.7
Credit-to-GDP ratio (in percent) 5/ 6/	144.8	137.6	122.6	122.6	122.6	122.6	122.6
Overnight policy rate (in percent)	1.75	1.75	2.75	...	...	...	...
Three-month interbank rate (in percent)	1.9	2.0	3.6	...	...	...	...
Nonfinancial corporate sector debt (in percent of GDP) 7/	109.7	108.9	97.6	...	...	...	...
Nonfinancial corporate sector debt issuance (in percent of GDP)	2.3	2.6	...	...	...	...	...
Household debt (in percent of GDP) 7/	93.1	88.9	81.0	...	...	...	...
Household financial assets (in percent of GDP) 7/	204.5	191.8	167.6	...	...	...	...
House prices (percentage change)	1.2	1.2	3.5	...	...	...	...
Exchange rates (period average)							
Malaysian ringgit/U.S. dollar	4.20	4.15	4.40	...	...	...	...
Real effective exchange rate (percentage change)	-3.5	-1.3	-1.5	...	...	...	...
Balance of payments (in billions of U.S. dollars) 5/							
Current account balance	14.1	14.5	12.5	10.2	12.2	13.3	14.9
(In percent of GDP)	4.2	3.9	3.1	2.4	2.7	2.8	2.9
Goods balance	32.7	42.9	42.3	33.7	37.0	39.8	42.8
Services balance	-11.2	-15.8	-12.8	-10.3	-10.8	-11.0	-10.8
Income balance	-7.4	-12.5	-16.9	-13.3	-14.0	-15.5	-17.2
Capital and financial account balance	-18.5	3.8	2.7	-11.3	-5.2	-1.9	-4.1
Of which: Direct investment	0.7	7.5	3.6	2.7	3.5	3.8	4.0
Errors and omissions	-0.1	-7.3	-3.1	0.0	0.0	0.0	0.0
Overall balance	-4.6	11.0	12.1	-1.2	6.9	11.5	10.8
Gross official reserves (US$ billions) 5/ 8/	107.6	116.9	114.7	113.5	120.4	131.9	142.6
(In months of following year's imports of goods and nonfactor services)	5.5	4.9	5.2	4.5	4.5	4.7	4.8
(In percent of short-term debt by original maturity)	117.6	120.8	105.1	91.9	90.7	89.7	88.3
(In percent of short-term debt by remaining maturity)	91.9	93.5	84.8	75.3	74.1	74.6	74.1
Total external debt (in billions of U.S. dollars) 5/ 8/	238.8	258.7	259.4	279.9	296.6	318.0	339.0
(In percent of GDP)	70.8	69.3	63.8	66.9	66.7	66.3	66.2
Of which: short-term (in percent of total, original maturity)	38.3	37.4	42.1	44.1	44.8	46.3	47.7
short-term (in percent of total, remaining maturity)	49.1	48.3	52.2	53.9	54.8	55.6	56.8
Debt service ratio 5/							
(In percent of exports of goods and services) 9/	13.6	10.5	9.7	11.3	11.9	12.0	11.3
(In percent of exports of goods and nonfactor services)	14.4	11.4	10.3	12.1	12.7	12.8	12.1
Memorandum items:							
Nominal GDP (in billions of ringgit)	1,418	1,549	1,791	1,910	2,061	2,215	2,365

Sources: Data provided by the authorities; CEIC Data; World Bank; UNESCO; and IMF, *Integrated Monetary Database,* and staff estimates.

1/ Data used in this report for staff analyses are as of January 30, 2024, unless otherwise noted. Official full year preliminary actual GDP is scheduled to be released on February 16th, 2024.

2/ Cash basis.

3/ Consolidated public sector includes general government and nonfinancial public enterprises (NFPEs). General government includes federal government, state and local governments, and statutory bodies.

4/ Based on data provided by the authorities, but follows compilation methodology used in IMF's *Integrated Monetary Database*. Credit to private sector in 2018 onwards includes data for a newly licensed commercial bank from April 2018. The impact of this bank is excluded in the calculation of credit gap.

5/ IMF staff estimates. U.S. dollar values are estimated using official data published in national currency.

6/ Based on a broader measure of liquidity. Credit gap is estimated on quarterly data from 2000, using one-sided Hodrick-Prescott filter with a large parameter.

7/ Revisions in historical data reflect the change in base year for nominal GDP (from 2010=100 to 2015=100).

8/ The decrease in short-term debt by remaining maturity in 2017 was partly due to the implementation of an improved data compilation system that corrected previous overestimation.

9/ Includes receipts under the primary income account.

INTERNATIONAL MONETARY FUND

MALAYSIA

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION

February 2, 2024

KEY ISSUES

Context. Malaysia's growth momentum has slowed but remains resilient to external headwinds. While monetary policy has paused its tightening cycle, fiscal policy is consolidating, and the ringgit had been under pressure through most of 2023. The government's commitment to the reform priorities outlined in its national strategic plans is yet to fully materialize, with the economy's path to high-income status hanging in the balance.

Economic Policy Recommendations. In view of the lower yet solid growth, positive projected output gaps, limited fiscal buffers, and ongoing energy price liberalization, near-term macro policies should focus on maintaining an overall tight policy stance to safeguard price stability, while rebuilding buffers and continuing targeted support to lower-income segments. Structural reforms would support medium-term growth. Specifically:

- *Mobilizing domestic revenues and rebuilding buffers:* The 2024 Budget appropriately charts the near-term fiscal consolidation path. Durably mobilizing revenues will not only address Malaysia's chronic revenue weakness but will also help finance development spending needs, while building buffers and putting debt on a firm downward path.
- *Safeguarding price stability*: The neutral monetary policy stance remains appropriate, and Bank Negara Malaysia (BNM) should maintain a tightening bias with a data-dependent approach, to keep inflation contained and expectations well anchored. The tightening bias is warranted by the ongoing yet uncertain subsidy reform, a weaker ringgit, and a low sacrifice ratio.
- *Ensuring continued financial sector soundness:* The financial sector remains healthy, but highly leveraged households and smaller firms warrant continued and close watch, given increased risks from high interest rates, and weaker growth. Close monitoring of banking profitability amid rising funding costs is also warranted, and updating stress test design can help monitor emerging risks.
- *Implementing growth-enhancing structural reforms*: The government faces the challenging task of implementing its well-crafted and concerted policy frameworks, which are appropriately focused on improving labor market outcomes and increasing incomes, addressing climate change, promoting digitalization, and enhancing governance. Missing from the policy agenda is a clear action plan to ensure a sustainable pension system for an ageing population.

Approved By
Sanjaya Panth (APD) and Eugenio Cerutti (SPR)

Mission dates: Dec 5–14, 2023. The mission met with the Governor of the Bank Negara Malaysia, the Secretary General of the Ministry of Finance, senior staff from various line ministries/public sector entities, and representatives from the private sector. Mission Team: Lamin Leigh (Head), Kodjovi Mawulikplimi Eklou, Ghada Fayad, Shujaat Khan (all APD), Natalia Novikova and Defa Zhao (Resident Representative Office in Singapore), Yue Zhou (APD) participated virtually; Raja Anwar (Alternate Executive Director) and Ahmad Faisal Bin Rozimi (Advisor to the Executive Director) joined the meetings. Ms. Fayad, senior desk, led the advance team for the first week of the mission. Ganchimeg Ganpurev and Justin Flinner (both APD) assisted in the preparation of this report. Data used in this report for staff analyses are as of January 30, 2024, unless otherwise noted.

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APPENDICES

CONTEXT: TIME FOR REFORMS AMID DOMESTIC AND GLOBAL FRAGILITIES

1. **Malaysia's growth momentum is slowing, albeit from a high base in 2022.** Against external headwinds, robust domestic demand continues to drive growth. Malaysia's strong macroeconomic policy frameworks, including a track record of fiscal prudence and a credible monetary policy framework have become more important as the country undergoes important structural reforms. A history of costly and untargeted spending on subsidies is coming to an end. The passing of the Fiscal Responsibility Act marks a crucial fiscal and governance milestone. A long list of fiscal and structural reforms remains in the pipeline.

2. **Going forward, amid the need for an overall tight macro policy stance and narrow policy space, growth will have to be supported by key productivity-enhancing structural reforms.** Positive projected output gaps, and upside inflation risks from planned subsidy reform, as well as elevated debt burdens and limited fiscal buffers, call for macro policies to maintain an overall tight stance. Malaysia's path to high-income status will critically depend on the government's ability to appropriately sequence and implement growth-enhancing structural reforms set out in its ambitious policy frameworks. This challenging task is more needed, given risks from geoeconomic fragmentation and from the growth slowdown in China, Malaysia's largest trading partner.

3. **The need for implementing structural reforms comes at a time of heightened global risks, internal political fragilities and rising calls for addressing pressing social issues.** Chief among them is increasing perennially low wages and ensuring a sustainable pension system for an ageing population after a few years of allowed pandemic-era withdrawals that have depleted retirement savings for many. Achieving tangible progress on the government's MADANI Economy Framework (MEF) and on the national strategic plans that followed (Appendix I), will both require and help domestic consensus.

RECENT DEVELOPMENTS: A SLOWING, YET STILL RESILIENT, RECOVERY

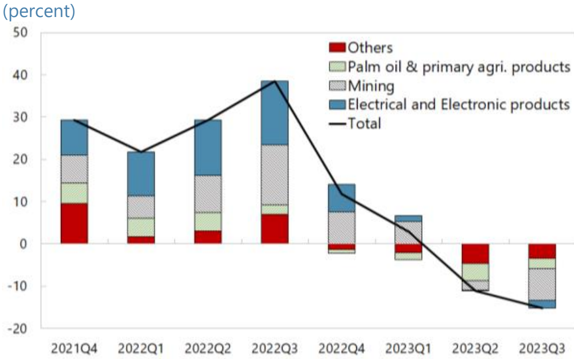
4. **Malaysia's economy is slowing.** Advance estimates suggest that growth in 2023Q4 moderated to 3.4 percent (2022: 8.7 percent), driven mainly by the services sector which was supported by the post-pandemic recovery in tourism. On the demand side, private consumption remained the main driver of growth, supported by a healthy labor market. Exports weakened markedly due to the economic slowdown in major trading partners, including China, and weak external demand (most notably for electrical and electronic (E&E) products). Credit growth has been strong at 4.7 percent in November 2023, driven by household demand and supported by the labor market recovery. The unemployment rate dropped to its pre-pandemic level of 3.3 percent in November 2023.

5. **Disinflation is taking hold.** After peaking at 4.7 percent in August 2022, headline inflation significantly moderated to 1.5 percent in December 2023, generally reflecting easing of energy and

food prices, and core inflation moderated to 1.9 percent, falling from its 4.2 percent peak last November. For the whole year, average headline and core inflation stood at 2.5 (2022: 3.4 percent) and 3 percent (2022: 3 percent), respectively. The inflation broadness index, which measures the percentage of items in the consumer price index (CPI) basket rising more than a certain threshold, has declined continuously in the past year, and inflation expectations remain well anchored.

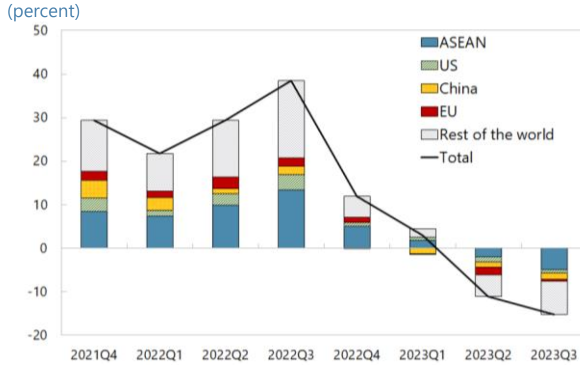
Malaysia: Contribution to Growth of Goods Exports

Malaysia: Contribution to Exports Growth by Product
(percent)



Sources: Haver and IMF staff calculations.

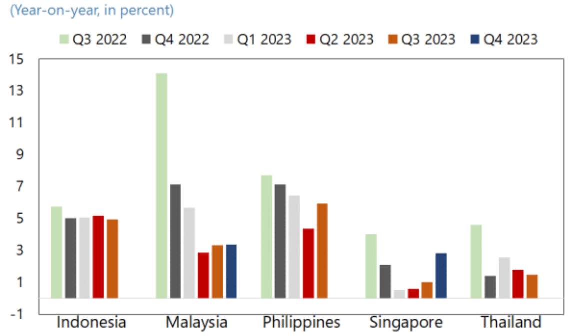
Malaysia: Contribution to Export Growth by Country
(percent)



Sources: Haver and IMF staff calculations.

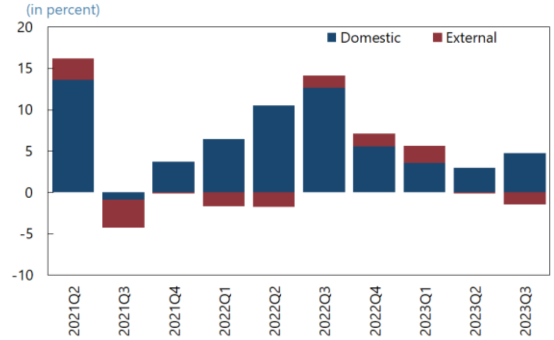
Malaysia: Macroeconomic Developments in ASEAN-5

ASEAN-5: Real GDP Growth
(Year-on-year, in percent)



Sources: Bloomberg, Haver, and IMF staff calculations. Note: 2023 Q4 number for Malaysia is an advance estimate.

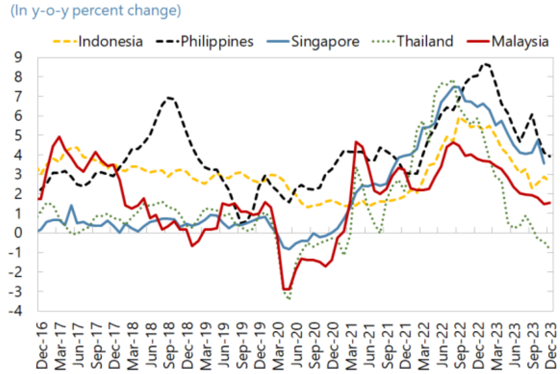
Malaysia: Contributions in GDP Growth (NSA, real)
(in percent)



Sources: Haver and IMF staff calculations.

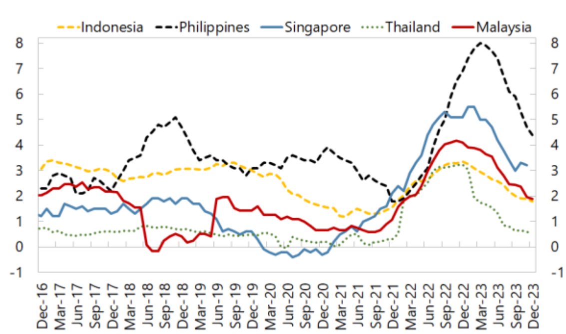
Malaysia: Inflation Developments in ASEAN-5

ASEAN-5: Headline Inflation
(In y-o-y percent change)



Sources: CEIC Data.

ASEAN-5: Core Inflation
(In y-o-y percent change)



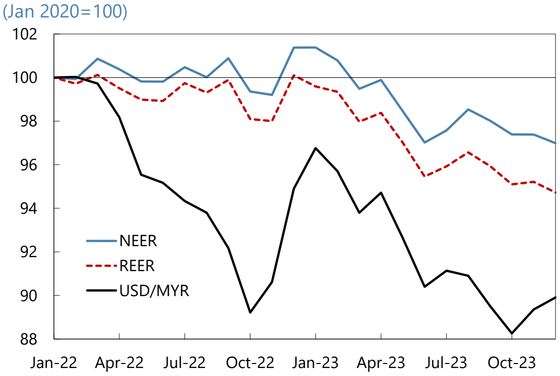
Sources: CEIC Data.

6. Malaysia faced external pressures through most of 2023. The weakening of the ringgit was broad-based during most of 2023. Negative interest rate differential between the overnight policy rate (OPR) and the US federal funds rate reached a historical low in recent months (of about -240 bps) and was one of the main drivers of the ringgit depreciation. Meanwhile, ringgit weakness was also highly correlated with renminbi moves over the period. External pressures have also manifested through capital outflows, primarily in the form of portfolio flows due to redemption of matured foreign currency debt and portfolio investment abroad by residents. Gross international reserves (GIR) declined from US$114.7 billion at end-2022 to US$113.5 billion at end-2023, causing the reserve coverage to decline from 113 to 110 percent of the ARA metric. As of mid-January 2024, however, reserves have increased to US$115.1 billion, surpassing their level at end-2022. Net international reserves (NIR), which had declined significantly in 2022 (US$71 billion at end-2022 relative to US$105 billion at end-2021), remained broadly stable in 2023 (US$70 billion at end-November 2023). The gap between GIR and NIR is primarily due to the use of FX swaps by BNM (about 21 percent of GIR at end-November 2023) to manage ringgit liquidity needs in the money market.

Malaysia: Recent Exchange Rate Market Developments

Malaysia: Exchange Rate Dynamics

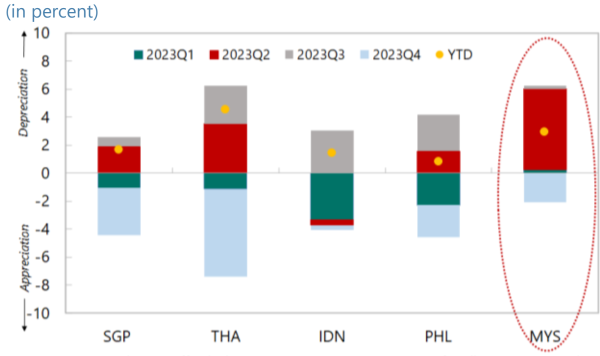
(Jan 2020=100)



Source: Bank Negara Malaysia and IMF staff calculations.

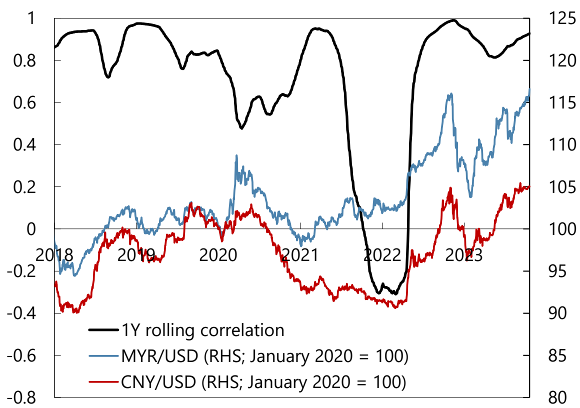
ASEAN-5: YTD Exchange Rate Movement Against USD

(in percent)



Sources: Haver and IMF staff calculations. Note: YTD = Jan 22 2024 for all except IDN and PHL which are as of the latest available date, Jan 18 2024.

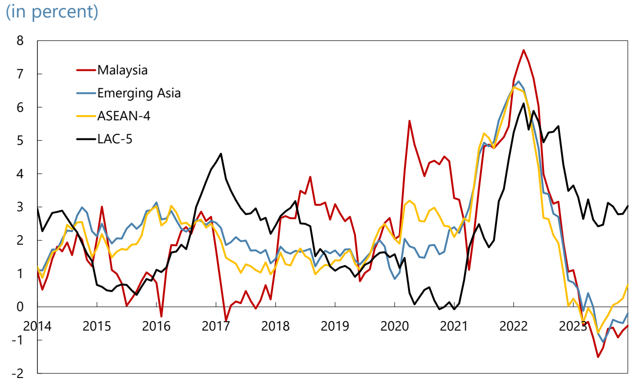
Malaysia: MYR/CNY Co-Movement



Source: Haver Analytics and IMF staff calculations.

Malaysia: Real Policy Rate Differential vs. US

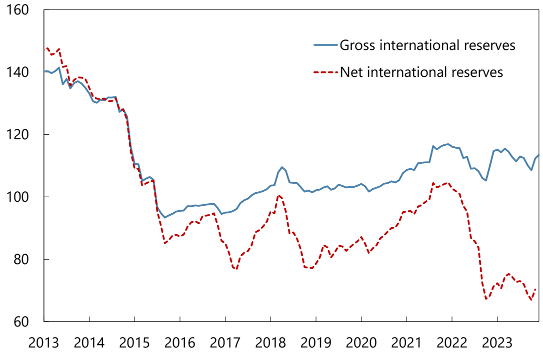
(in percent)



Source: Haver Analytics, BIS, and IMF staff calculations.
Note: Real policy rate differentials are defined as the difference between the domestic real policy rate and the US real federal funds rate. Real interest rate is the difference between nominal interest rate and inflation. Simple average of interest rate differentials. LAC-5: BRA, CHL, COL, PER, and MEX. ASEAN-4: IDN, MYS, PHL, and THA. Emerging Asia: IND, IDN, MYS, PHL, THA, and VNM.

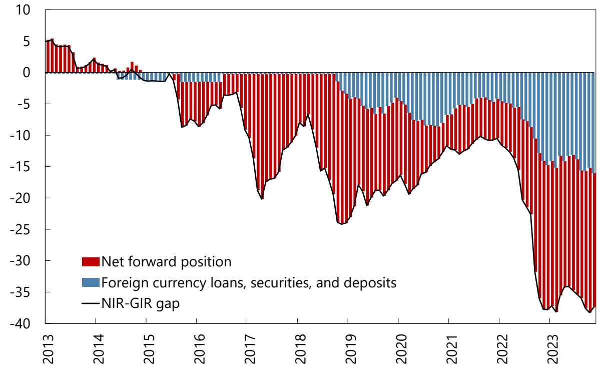
Malaysia: Recent Exchange Rate Market Developments (concluded)

Malaysia: International Reserves
(in billions of US$)



Source: Bank Negara Malaysia and IMF staff calculations.

Malaysia: Short-term Drains on FX Reserves
(in percent of GIR)



Source: Bank Negara Malaysia and IMF staff calculations.

7. The 2024 Budget charts a continued near-term consolidation path. The 2023 Budget deficit target of 5 percent of GDP is expected to be met, down from 5.5 percent in 2022. Stronger than expected revenue collection throughout 2023, notably from tax revenues, was counterbalanced by equally higher than budgeted expenditures to finance spending on subsidies and on initiatives under the MADANI economic framework. Amid a projected positive output gap, the 2024 Budget envisages continued consolidation toward a 4.3 percent deficit in 2024, driven by lower spending on subsidies given the subsidy reform in motion and on development expenditure as well as limited new tax measures.[1] Revenues are instead projected to decline in percent of GDP driven by a fall in petroleum-related non-tax revenues and limited revenue-generation power from the new tax measures of about 0.3 percentage points of GDP (text table).[2] The significant expected decline in subsidies and in petroleum revenues despite a higher oil price assumption of $85 per barrel (vs. $80 in 2023) reflects a combination of conservative revenue assumptions, and of a subsidy reform in motion. While plans to re-introduce the goods and services tax (GST) were absent from the 2024 Budget, the path to the medium-term deficit target incorporates additional revenue mobilization efforts and savings from subsidy re-targeting (1.1 and 0.5 percentage points of GDP, respectively).

Malaysia: Components of Consolidation

In percent of GDP	2023	2024	Change
Revenues	15.9	14.9	-1.0
Tax	12.0	11.8	-0.2
Non-Tax	3.9	3.1	-0.8
Expenditures	20.9	19.2	-1.7
Current	15.7	14.7	-1.0
Subsidies	3.4	2.6	-0.8
Interest	2.4	2.4	0.0
Development	5.1	4.5	-0.6
Deficit	-5.0	-4.2	0.8

[1] With staff nominal GDP projection for 2024, this translates into a deficit of 4.2 percent of GDP.

[2] Estimated revenues from the 2024 Budget revenue measures are conservatively excluded from authorities' and staff's revenue projections for 2024.

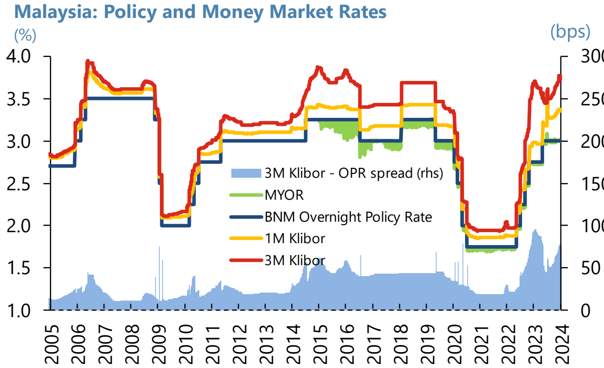
Malaysia: Tax Measures in the 2024 Budget

New measures	Details	Effective date
Excise duty on chewing tobacco	5 percent plus RM27/kg	Jan-24
Capital gains tax	Implementation of a 10 percent on disposal of unlisted shares for local companies	Mar-24
High value goods tax	5-10 percent on certain high value items	NA
e-Invoicing	Implementation of e-invoicing for all taxpayers	Aug-24 for taxpayers with annual turnover/revenue above RM100 million; full implementation by 1 July 2025
Global Minimum Tax	Applies to companies with global income of at least EUR 750 mn	2025
Changes to existing measures		
Excise on sugary drinks	Increase to MYR0.50/liter from MYR0.40/liter	Jan-24
Services tax	Increase to 8 percent from 6 percent except food and beverages and telecommunication services	NA

8. **Monetary policy has remained on pause since May 2023 after a gradual normalization.** The BNM increased the overnight policy rate (OPR) five times since May 2022 by a total of 125 bps to 3.0 percent (the prevailing OPR level pre-pandemic). BNM's January 2024 statement highlighted that the decision to maintain the OPR at 3.0 percent was consistent with the continued easing of headline and core inflation amid moderating cost pressures and stabilizing demand conditions.

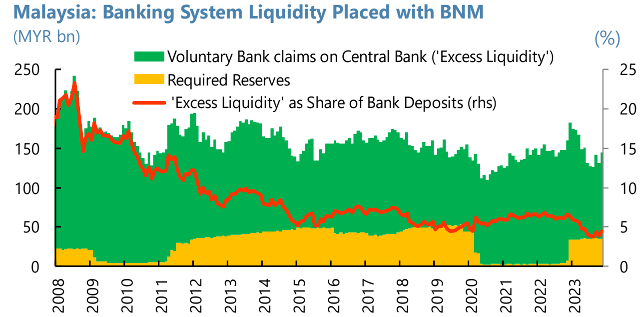
9. **Financial conditions remain broadly accommodative.** Financial conditions eased for most of 2023, as domestic inflation moderated, and investors curbed expectations of further BNM hikes in the second half of the year. The spread between OPR and 3-month Kuala Lumpur Interbank Offered Rate (Klibor) rose to just below 100 basis points in January 2023 as banks adjusted to no longer being allowed to recognize government securities as part of Statutory Reserve Requirement (SRR) amid monetary policy tightening and increased demand for ringgit loans.[3] While signs of deposit competition have diminished, the spreads remained above levels observed in previous hiking cycles.

Malaysia: Policy and Money Market Rates



Sources: Bloomberg; BNM; and IMF staff calculations.

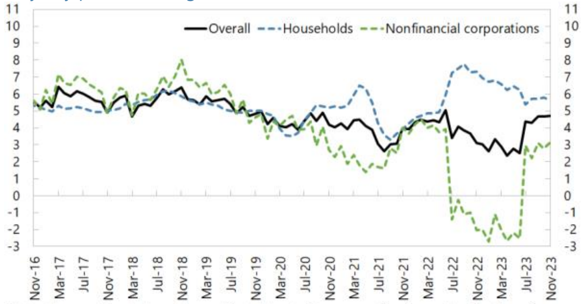
Malaysia: Banking System Liquidity Placed with BNM



Sources: BNM; CEIC; and IMF staff calculations.
Notes: Excess Liquidity is calculated by Banks' net claims on BNM less the required reserves. Required Reserves are statutory reserves banks need to hold in their Statutory Reserve Accounts equivalent to a certain proportion of their eligible liabilities, based on the Statutory Reserve Requirement rate

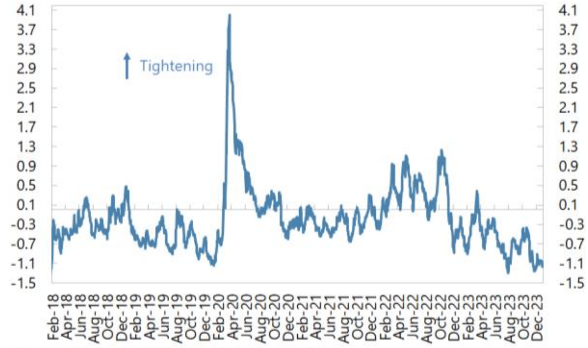
[3] As part of pandemic relief measures, banking institutions were allowed to recognize Malaysian Government Securities (MGS) and Malaysian Government Investment Issues (MGII) as part of SRR. This flexibility ended on December 31, 2022.

Malaysia: Bank Credit to Private Sector
(in y-o-y percent change)



Note: The growth rates have been adjusted by staff to account for the re-classification of a non-bank to bank in April 2018.
Sources: IMF, *Integrated Monetary Database*; and IMF staff calculations.

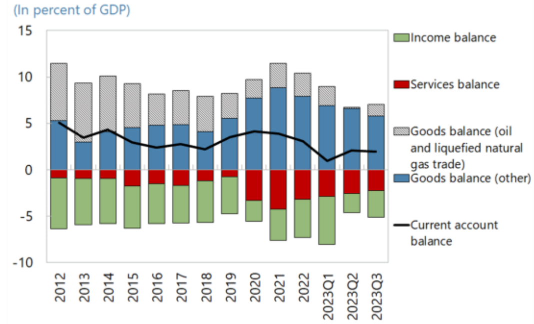
Malaysia: Daily Financial Conditions Index
(Standard deviations)



Sources: Bloomberg LP and IMF staff calculations.

10. The financial system continues to record healthy capital and liquidity positions. The banking sector total capital ratio stood at 18.1 percent, with common equity Tier 1 capital ratio at 14.5 percent, well above minimum requirements in November 2023. Banks rely on well-diversified deposit base, and the liquidity coverage ratio and net stable funding ratio stood healthy at 149.7 percent in November 2023 and 116.1 percent respectively as of September 2023, supported by high-quality liquid assets. Asset quality continued to hold up, with nonperforming loans (NPL) at 1.7 percent of total loans as of September 2023. The recovery of the banking system profitability continued albeit at a more moderate pace amid higher funding costs, supported by lending activities. The housing market continued to improve, supported by the home ownership initiative and better income and labor market conditions.

Malaysia: Current Account Balance
(In percent of GDP)



Sources: CEIC Data Co. Ltd.; Haver Analytics; and IMF staff calculations.

11. Malaysia's external position in 2023 is preliminarily assessed to be stronger than warranted by fundamentals and desired policies (Appendix IV). The current account surplus is estimated to decline to 2.4 percent of GDP in 2023 from 3.1 percent of GDP in 2022, driven by muted demand for E&E products amid a global technology downcycle, and lower oil and gas exports. Adjusting for cyclical factors, Malaysia's current account gap is assessed in the range of 2.7–3.7 percent of GDP, which implies a REER undervaluation in the range of 5.4–7.4 percent.[4] Weak social safety nets, proxied by low public healthcare expenditure, and relatively looser fiscal policy adopted by the rest of the world, contributed to Malaysia's excess current account surplus.

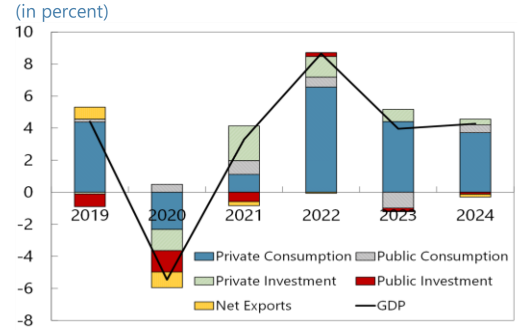
12. Economic policies have been broadly consistent with past Fund advice. The authorities are anchoring fiscal policy on their medium-term consolidation objective. Monetary policy has been data dependent and in line with past advice. The authorities continue to indicate their commitment to exchange rate flexibility as the first line of defense against external shocks.

[4] The assessment is preliminary, pending a complete analysis in the 2024 External Sector Report.

OUTLOOK: RESILIENT GROWTH AMID UPSIDE RISKS TO INFLATION

13. Resilient domestically driven growth and upside risks to inflation define the near-term outlook. Growth is estimated at about 4 percent in 2023, significantly lower than in 2022 (8.7 percent), and is projected to slightly accelerate to 4.3 percent in 2024, supported by resilient private consumption and investment, a recovery in the external demand for E&E products, and a rebound in public spending. The output gap is projected to remain positive in 2023 and 2024. Inflation is projected to pick up to 2.9 percent in 2024, up from 2.5 percent in 2023, pending uncertainty around subsidy reform.

Malaysia: Contributions to Real GDP Growth
(in percent)



Source: Haver Analytics, IMF staff calculations.

14. The balance of risks is tilted to the downside. (Appendix V):

- **External risks**: include the possibility of an abrupt global slowdown or recession, including in China (Malaysia's largest trading partner), with an associated spike in global risk premia, capital outflows and sudden stop risks. Monetary policy miscalibration could lead to a new cycle of aggressive tightening of monetary policy by major central banks leading to rapidly tightening financial conditions with implications for domestic balance sheets. As a commodity exporter, Malaysia is also vulnerable to commodity price shocks and associated volatility. China's weaker medium-term growth poses a major risk for Malaysia.
- **Domestic risks**. Domestically, fiscal risks from contingent liabilities could materialize and could necessitate additional measures to ensure medium-term fiscal sustainability. Any potential renewed political uncertainty could disrupt the government's reform momentum.

Authorities' Views

15. The authorities broadly agreed with staff assessment of the outlook. Resilient domestic demand in 2023 was underpinned by a supportive labor market with labor shortages easing across sectors and the labor force participation rate at all-time highs. The authorities expect the economy to grow at about 4 percent in 2023 and, between 4 and 5 percent in 2024, supported by sustained private consumption and a rise in private investment due to policy initiatives, accompanied by a recovery in electrical and electronic product exports and tourism. The authorities expect inflation to be in the range 2.1–3.6 percent in 2024 with upside risks associated with the ongoing retargeting of subsidies. They envisage the current account surplus to moderate in 2023 and reiterated their concerns over the large unexplained residual (about three-fourth of the CA gap) in the EBA. Nonetheless, they concurred with the need for structural reforms to enhance external rebalancing. While they recognize risks from geoeconomic fragmentation and China's medium-term growth slowdown, they see trade diversification across product markets and countries as well as tourism diversification as mitigating factors.

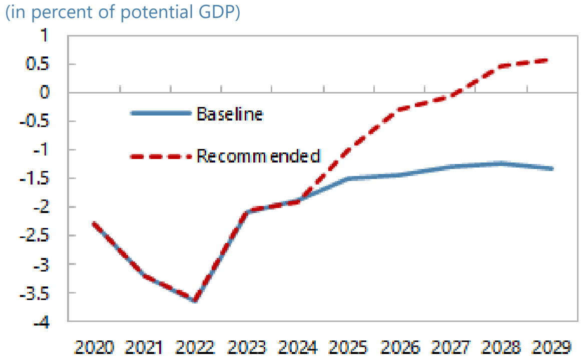
POLICIES TO REBUILD BUFFERS AND MANAGE RISKS WHILE SUPPORTING MEDIUM-TERM GROWTH

A. Fiscal Policy: Time to Mobilize Revenues and Rebuild Buffers

16. A gradual and credible medium-term fiscal consolidation is warranted to put debt on a firm downward path. Limited fiscal buffers, positive output gaps projected in the next few years, large contingent liabilities, amid moderate risk of debt distress (Appendix II), support the need for Malaysia to leverage the recovery to rebuild a significant buffer against the debt limit.[5] The 2024 Budget consolidation trajectory until 2026 is consistent with the staff recommended deficit path. Achieving the latter however requires identifying high-quality and durable revenue measures to generate the needed revenue streams and buttress market confidence on Malaysia's fiscal policy credibility.

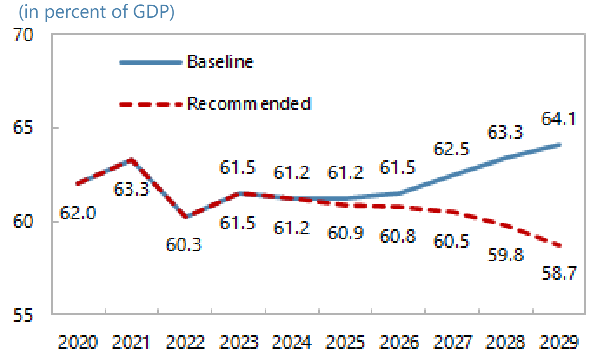
Malaysia: Fiscal Policy: Baseline and Proposed Staff Advice[1]

Malaysia: Structural Primary Balance
(in percent of potential GDP)



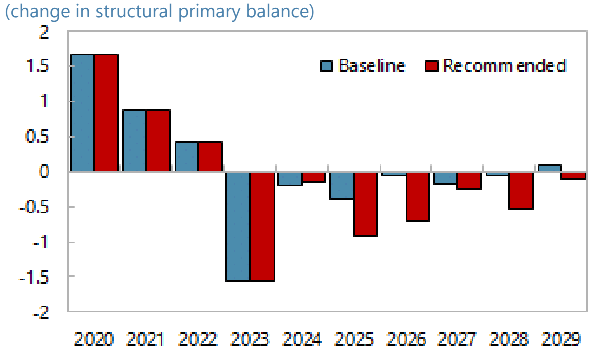
Sources: IMF staff calculations.

Malaysia: Federal Government Debt
(in percent of GDP)



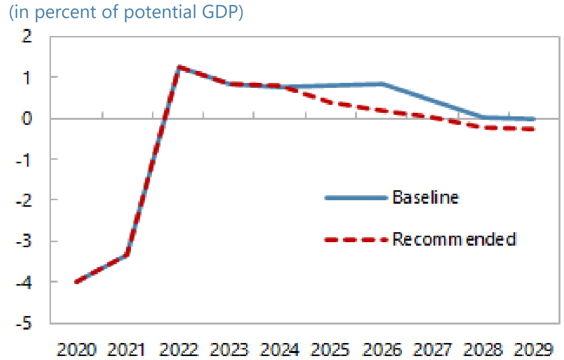
Sources: IMF staff calculations.

Malaysia: Fiscal Impulse
(change in structural primary balance)



Sources: IMF staff calculations.

Malaysia: Output Gap
(in percent of potential GDP)



Sources: IMF staff calculations.

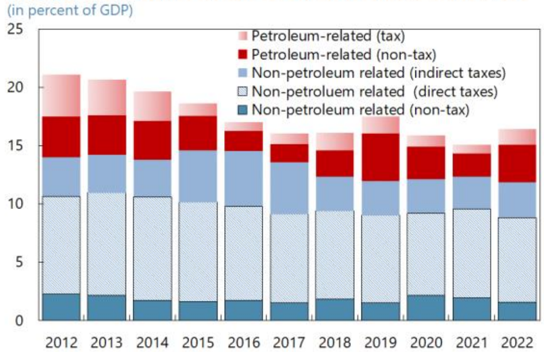
[1] See appendix VII in the 2022 Article IV CR 22/126 on the optimal fiscal stance model.

[5] Staff's baseline is passive and deviates from the authorities' deficit targets beyond 2024 as those are not supported by clear well-identified measures.

17. Malaysia can potentially collect 15 percent of GDP in tax revenues based on its economic and institutional characteristics (Appendix VI). Notwithstanding progress on decreasing reliance on petroleum-related revenues over the last decade, tax revenue collection weakened to less than 12 percent of GDP in 2022, down from over 15 percent a decade ago. This has made Malaysia's tax performance more comparable to low-income than emerging market peers. Based on a tax frontier analysis, staff estimate that Malaysia can collect an additional 3 percent of GDP over current levels in the short to medium term. While this estimated tax potential is not necessarily the optimal level of taxation, it provides a credible medium-term target that the authorities can work toward, within a medium-term revenue strategy (MTRS).

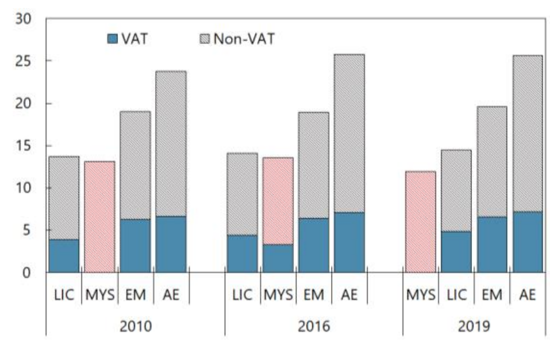
18. Malaysia can achieve its tax potential by reintroducing the GST while ensuring that any regressivity is addressed through spending. Malaysia ranked well on the C-efficiency score of the GST when the latter was in place during 2015-17.[6] The score is an indicator of the departure of GST from a perfectly enforced tax levied at a uniform rate on all consumption. Malaysia's policy and compliance gap towards a perfect score could be potentially addressed through continued focus on improving revenue administration as well as on reducing leakages and tax expenditures. While regressivity of the GST may be a concern, it is not conclusively so. Fundamentally, rather than any one tax, it is the tax and public spending system that affects and matters for equity. Furthermore, revenues collected from the GST can help finance pro-poor spending, which more than offsets any regressive effect of the tax itself.

Malaysia: Revenues From Petroleum-related and Taxes
(in percent of GDP)



Sources: Country authorities and IMF staff calculations.

Malaysia: Tax Revenues: VAT vs. Non-VAT
(in percent of GDP)



Sources: IMF World Revenue Longitudinal Data (WoRLD) and IMF staff calculations.

19. The discussion of the long-awaited subsidy reform in the 2024 budget should be accompanied by necessary further details on timing and magnitudes, including over the multi-year horizon. Staff welcome the focus on gradualism and channeling of savings from subsidy reform towards higher cash assistance and development spending. The ongoing re-targeting of electricity subsidies by consumption, which started in 2023, is shifting them away from the top 10 percent of electricity consumers. A phased retargeting of industrial diesel subsidies towards public transportation and goods transportation/logistics sectors will start in Q1 2024, building on an existing system of fleet cards allowing targeted sectors to access diesel at subsidized prices. No details on RON95 pumping gas subsidies, the largest component of the subsidy bill, were

[6] Malaysia first introduced the GST in April 2015 at a standard rate of 6 percent. It was later abolished in May 2018.

announced, but the wide inflation forecast range in 2024 of 2.1-3.6 percent suggests that RON95 price liberalization may still be in the pipeline. The mechanism, as well as coverage, for compensating lower-income households have not been finalized. A key first step was the launching on January 1, 2024, of Padu, a socioeconomic central database, that will be used for appropriately targeting transfers.[7]

20. The historic passing of the Public Finance and Fiscal Responsibility Act (FRA) in October 2023 is a welcome step. The new law will enhance governance and accountability, requiring more transparency in financial reporting including the publishing of a mid-year expenditure performance report, a comprehensive fiscal risk statement, and a tax expenditure statement. The Act requires the minister of finance to formulate a Medium-Term Fiscal Framework, supported by a medium-term revenue strategy and a public expenditure policy, to guide fiscal planning and priorities over a three-to-five-year period, and sets several numerical targets to be achieved within that period. In the event of sudden shocks, the bill allows temporary deviation from the fiscal objectives, provided the Cabinet approves the minister's assessment of the impact of the shock on economic and fiscal positions, and in turn the proposed fiscal adjustment plan prepared in response to the shock (to be then presented to parliament). In addition to the numerical limit on guarantees, it also appropriately includes provisions to ensure a rigorous process for granting and monitoring of guarantees, with the aim of decreasing the government's exposure and provide mitigation plans if such guarantees are called.

Malaysia: Fiscal Objectives Under the FRA

Fiscal Objectives (as percentage of GDP)	Thresholds (percent)
Annual development expenditure incurred	≥ 3
Fiscal balance	≤ -3
Debt level	≤ 60
Financial guarantee	≤ 25

Authorities' Views

21. The authorities are undergoing important fiscal reforms that are expected to underpin their fiscal consolidation path. They see the recently passed Fiscal Responsibility Act as an anchor for other fiscal reforms. They are proceeding with gradual subsidy retargeting, across both energy products and time, which they see as complementary to their planned reduction of dependence on petroleum-related revenues. Operational modalities and coverage for compensating lower-income households for fuel price liberalization will be rolled out in 2024. They agreed that the revenue measures of the 2024 Budget are expected to generate modest yields, and that achieving the medium-term fiscal deficit target would necessitate major steps such as revamping the current sales and services tax or reintroducing a carefully designed and improved consumption tax. The work on a medium-term revenue strategy (MTRS) continues; the strategy paper is planned for approval by the Fiscal Policy Committee by August 2024 with some elements to feature in the 2025 Budget. They are thankful to past Fund capacity development (CD) support and expressed interest in further CD on their MTRS, and on developing a tax expenditure assessment, one of the requirements under the FRA.

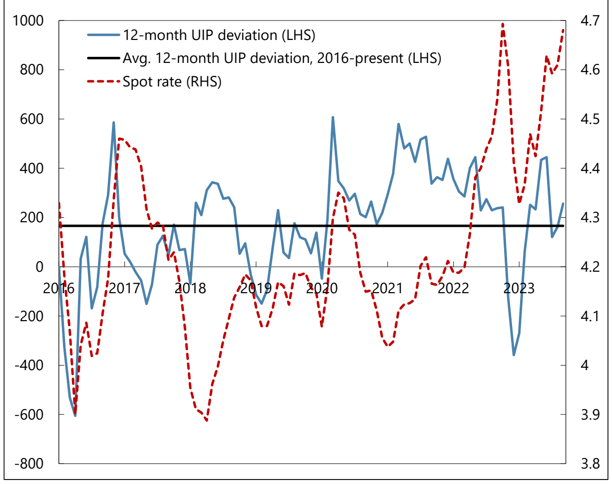
[7] Please see Appendix VI of CR 23/185 for more details on the elements needed for a successful long-lasting subsidy reform drawing on past country experiences.

B. Monetary and Exchange Rate Policies: Tightening Bias Amid Upside Risks to Inflation

22. The broadly neutral monetary policy stance is appropriate; the BNM should keep a tightening bias in the near term in a data dependent manner. Staff estimates of the neutral real rate suggest that the monetary policy stance is currently broadly neutral. Upside risks to inflation include ongoing yet uncertain subsidy reform, more protracted US dollar strengthening, and potential commodity price spikes amid geopolitical tensions. These risks argue for the BNM to maintain a tightening bias and avoid premature easing of the monetary policy stance. The tightening bias is also warranted by estimated low sacrifice ratio and would ensure that (long-term) expectations remain anchored.[8] More broadly, the BNM should continue to clearly communicate the rationale for its policy decisions, given high uncertainty.

23. Exchange rate flexibility and reserve adequacy should be preserved. In the context of Malaysia's shallow FX market, the Integrated Policy Framework (IPF) may warrant the use of FX interventions (FXI) to smooth large changes in hedging and financing premia if they generate risks to macroeconomic and financial stability. FXI is not however a substitute for needed policy adjustment and should not be used to lean against exchange rate pressures that are driven by fundamentals. Opportunistic reserve accumulation would be appropriate during risk-on episodes, given the decline in the GIR coverage and significantly lower NIR. The latter implies an eventual drain on reserves once BNM's short FX forward positions are settled. However, as external pressures ease, GIR is expected to be bolstered by the conversion of FX proceeds by exporters. Reserve accumulation, however, should not interfere with the needed real exchange rate appreciation over the medium term, given that Malaysia's 2023 external position is preliminarily assessed to be stronger than implied by fundamentals and desirable policies. A steady increase in daily FX turnover, averaging about US$15.5 billion in 2023, relative to US$12.1 billion over the preceding 5 years, is encouraging and indicative of the ongoing and welcome steps taken by the BNM to liberalize and deepen the FX market and, among other things, to enhance price discovery. In this context, existing CFMs should be gradually phased out with due regard to market conditions. Publication of FXI data (with an appropriate lag to guard against market sensitivities) could enhance communication and strengthen the commitment to the monetary policy framework.

Malaysia: UIP Deviations
(LHS: in basis points; RHS: MYR/USD)



[8] See Appendix VII of IMF Country Report No. 23/185 for staff estimates of the sacrifice ratio.

Authorities' Views

24. **BNM stressed its commitment to maintaining price stability.** They concurred with staff assessment that the current monetary policy stance is broadly neutral and appropriate, and noted that going forward monetary policy calibration will continue to be data dependent and deliberative. They are cognizant of the potential upside risks related to the subsidy reform, but at the same time, they are confident in their ability to respond to any associated second-round effects building on their track record. Such risks would be largely dependent on the coverage and impact of cash transfers on domestic demand as well as changes in firms' price setting behavior.

25. **The authorities noted that a flexible exchange rate continues to play the role of a shock absorber and Malaysia's strong economic fundamentals would help mitigate external risks.** They highlighted that the external environment, particularly the high interest rates in most major economies, particularly the US, was the main driver of the ringgit's performance this year as also experienced by many other regional currencies. Meanwhile, they noted that the often-cited high correlation of the ringgit with the renminbi could be explained not just by trade and tourism linkages, but also by market sentiment during risk-off episodes. They mentioned that FX interventions by BNM, which are done in a two-sided manner, were aimed towards smoothing excessive volatility of the ringgit and to facilitate price discovery. The authorities also noted that the depreciation of the ringgit was not reflective of Malaysia's economic fundamentals, as growth remained robust in 2023 and, going forward, a diversified external sector, both in terms of products and trading partners, should moderate the co-movement of the ringgit with the renminbi. They highlighted that some of the measures that staff classify as capital flow management (CFMs) measures are not meant to restrict capital flows but are used as part of the financial stability toolkit as well as prudential measures. These measures have helped to strengthen onshore intermediation and remain critical for the development and resilience of the domestic FX market, consistent with the BNM mandate.

26. **The authorities view further increasing their FX reserve coverage as a priority and risks stemming from future short-term drains on reserves to be manageable.** They noted that while BNM's FX reserves had declined in the face of external pressures throughout most of 2023, there was a sizeable increase in the last two months of the year, which improved the overall reserve coverage. BNM's net short forward positions, which increased in 2022, are a result of FX swaps that BNM used largely to manage the level of domestic ringgit liquidity through sterilization of intervention. The need for intervention, in part, stems from reduced liquidity from exporters who, following the relaxation of export conversion requirements in 2021, decided to temporarily defer the conversion of their FX proceeds in the face of depreciation pressures. Relatedly, the increase in short-term FX deposits at BNM is also partly linked to increased FX holdings by corporates and exporters. Once external pressures subside, BNM is confident that the short forward positions can be unwound without significantly impacting gross international reserves, supported by the fact that the counterparties in these swap contracts are domestic entities.

C. Financial Sector Policies: Enhancing Resilience Amid Rapidly Evolving New Risks and Changing Landscape

27. The financial system appears resilient, with systemic financial risks contained, but close monitoring of banking profitability amid rising funding costs is warranted. Banks continue to hold strong capital and liquidity buffers, against increased exposure to higher interest rate risks owing to large government bond holdings. This is coupled with some compression in net interest margin as funding cost increased due to intensification of deposit competition, arguing for a careful monitoring of related financial stability risks. Undertaking integrated solvency-liquidity stress test would be desirable given the exposure of banks to higher interest rate risks. The BNM should maintain strong supervision of lending standards and continue to enhance monitoring of risks build-up, including due to higher interest rates amid weakening of growth momentum. The BNM should also continue to maintain strong surveillance of non-bank financial institutions--NBFIs (insurance and takaful operators).

28. Pre-emptive development of additional macroprudential tools as well as close monitoring of household balance sheets is warranted given existing pockets of vulnerabilities amid higher interest rates. Household debt is now slightly below pre-pandemic levels at 81.9 percent of GDP as of 2023Q2. While overall household balance sheets remain resilient with financial assets about 2 times larger than household debt in June 2023, as retirement savings bounced back strongly, pockets of vulnerabilities remain in some segments of vulnerable household borrowers. Staff recommend further pre-emptive broadening of macroprudential policy toolkit, to ensure that the variety of tools[9] (including the introduction of sector-wide loan-to-value (LTVs) on first and second properties) are ready to be deployed to address any risk build-up, including potential risks arising from the sizeable share of floating rate loans, and increased interest rates.

29. Monitoring of emerging weaknesses and pockets of financial vulnerabilities among firms should continue. Interest coverage and liquidity ratios for the corporate sector were healthy as of 2023Q3. The share of firms-at-risk—the proportion of non-financial corporates with an interest coverage ratio below 2—moderated to 26 percent in 2023Q3 but remains above pre-pandemic levels. Elevated input cost and weak external demand continued to weigh on business profitability for SMEs in construction, agriculture, and manufacturing. Loans-in-arrears have consequently risen across these sectors, but financial vulnerabilities remain confined to a small portion of SMEs. BNM stress test shows however that banks have sufficient capital buffers to absorb large credit losses from the corporate sector. Staff recommend that the BNM continue to enhance its existing corporate surveillance monitoring as global growth weakens, geoeconomic fragmentation intensifies and post-pandemic pent-up demand tapers off. The BNM should also continue to enforce robust monitoring, including timely information gathering to assess credit risk, particularly for SMEs, and full provisioning of expected losses.

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[9] See IMF Country Report No. 23/185 for more details.

30. The authorities have taken important steps to enhance the AML/CFT framework, but additional steps are required to ensure effective implementation. The authorities are encouraged to ensure effective beneficial ownership (BO) transparency implementation by issuing updated guidance for reporting institutions in line with the updated international standards and through strengthening supervisory and monitoring activities. In October 2023, authorities tabled the Companies (Amendment) 2023 Bill for first reading. This amendment, if passed and implemented effectively, can bring greater clarity and transparency to Malaysia's corporate environment, and support ongoing efforts to enhance tax compliance. The amendment is designed to bring the country in line with the revised international AML/CFT standards on beneficial ownership transparency (FATF Recommendation 24) issued in March 2022. In particular, the amendment codifies the need to maintain BO information in the Register of Beneficial Owners (RBO); expands the definition of a beneficial owner; and requires companies to obtain information on its beneficial owners.

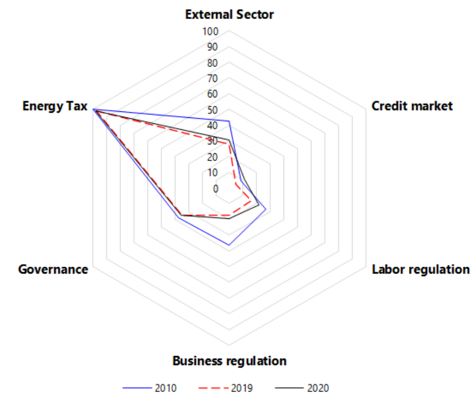
Authorities' Views

31. The authorities broadly shared staff assessment that systemic financial risks remain contained. They stressed that the financial system remains resilient, with banks continuing to hold strong capital and liquidity buffers. Weaker asset quality in banks' overseas operations was driven mainly by higher interest rates and continued repayment assistance in some of the markets and does not pose any risk to domestic financial stability. BNM continues to monitor small pockets of vulnerabilities including for SMEs in a few industries, as well as banks' funding costs, which tend to rise at the end of the year. Meanwhile, coming from the pandemic, BNM took steps to strengthen operational frameworks for crisis management and preparedness among financial institutions. BNM's analysis shows that although NBFIs hold substantial equity positions in banks, risks to the financial system are limited given large liquid assets. They see cyber security, climate-related, and market risks (higher for longer interest rates) as key risks that warrant close monitoring going forward. BNM also views the current macroprudential measures to be broadly appropriate given sizeable financial buffers, and minimal speculative activity in the real estate sector. Nevertheless, they see the need for pre-emptive broadening of the macroprudential toolkit as warranted.

D. Structural Reforms: Identifying and Closing the Gaps, and Reaping the Payoffs

32. There is room for structural reforms to boost potential growth and wages in Malaysia (Appendix VII). Empirical evidence shows that major governance, external sector, business regulation and domestic credit market reforms can accelerate growth in emerging and developing countries. Further, addressing the initial structural gaps in Malaysia as measured by the degree of informality and the high private debt are likely to amplify gains from structural reforms. While each of these reforms individually can promote growth, gains and synergies could be maximized through proper prioritization, packaging, and sequencing of reforms. Implementing first a package of reforms that includes governance and anti-corruption, external sector reforms to enhance export product space and more economic complexity, labor market and business regulation has the potential to significantly accelerate output growth. This sequencing can also help alleviate short-term tradeoff between promoting growth and reducing emission as the growth acceleration could offset some of the short-term costs associated with climate policies and create fiscal space to engage in the green transition.[10]

Malaysia: Structural Gaps in Malaysia Compared to Global Frontier



Note: Structural gaps are obtained as deviations from the frontier (the top performer in each macro-structural area in each year), in percent. Note that from IMF climate change indicators dashboard, MYS does not have energy tax revenues until 2018, hence a gap of 100 percent in 2010. Source: Budina et al. (2023).

33. Wage levels and growth rates in Malaysia have been structurally low, with changes incommensurate with productivity and a narrowing education premium (Appendix VIII). Malaysia's labor force has not sufficiently reaped the benefits of industrialization. Low pay incidence (percentage of the workforce earning less than two thirds of the median wage) is estimated at over 30 percent, significantly higher than the OECD's 14 percent. As a result, Malaysia's labor share of income has remained low. While there is almost no gender pay gap (below that of many advanced economies), the link between wages and productivity has been weak and a large gap exists between the highest and lowest or mid-qualified. This is despite wage growth for the lowest qualified over the last decade (driven by introduction of minimum wage) and amid stagnant wage growth for the high and semi-skilled. Decreasing skilled job creation combined with increasing share of the labor force with tertiary education has resulted in increasing skill-related underemployment, outward skilled migration, and more skilled workers choosing to be self-employed. If left unaddressed, this could lead to lower incentives to pursue higher education. Furthermore, extending tax incentives for women to return to work and expanding childcare services through building new facilities, will help to improve female participation rates.

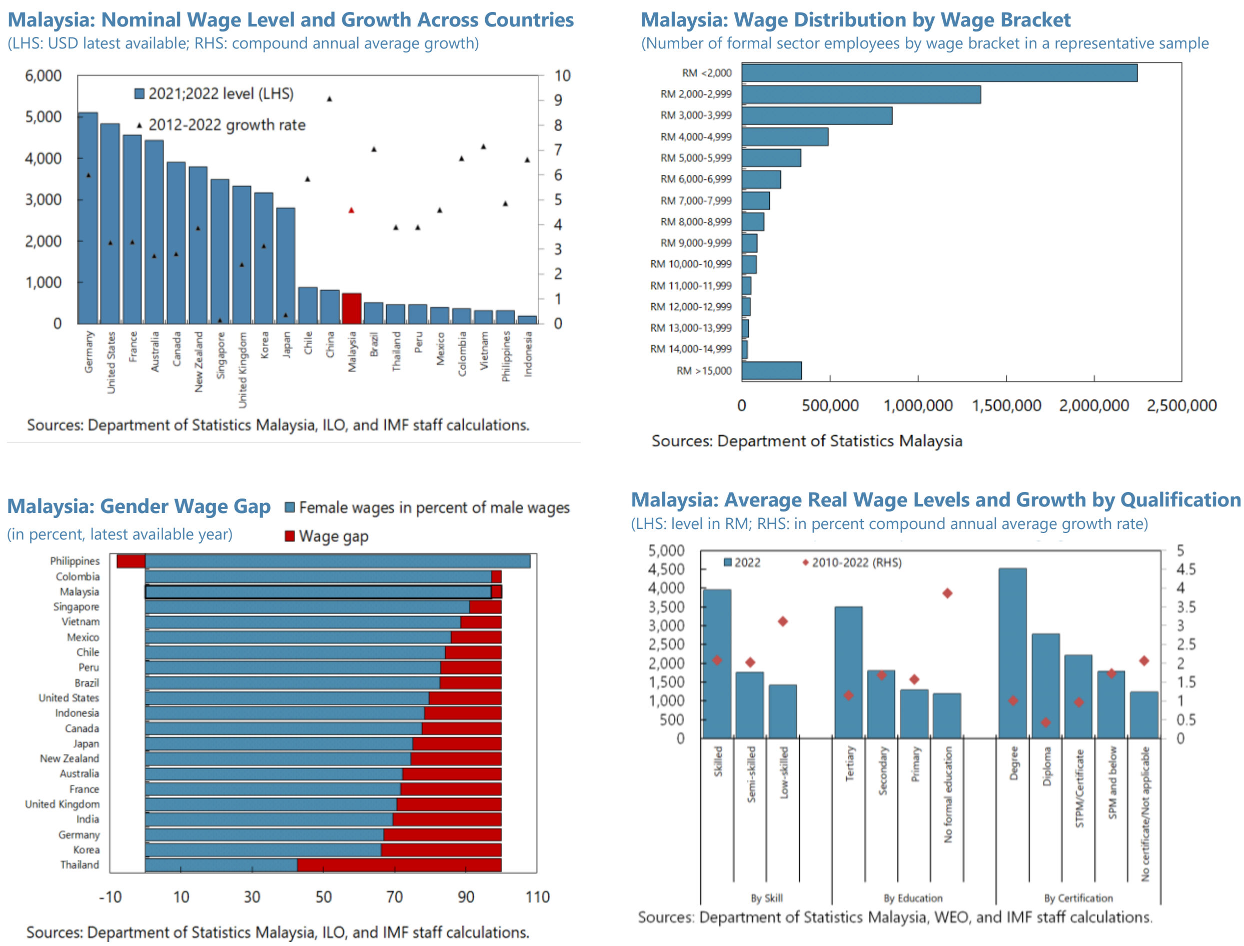
34. Achieving the MADANI Economy Framework's medium-term target of 45 percent labor income share will require the right set of policies. Sustained wage growth at all skill levels is needed. While the minimum wage introduction since 2013 has somewhat lifted low-skilled wages, the link between wages and productivity can be strengthened across all skill levels, through a flexible and competitive wage system that establishes a closer link between wages and productivity. In that respect, the planned implementation next year of a voluntary- and incentives-based productivity-linked Progressive Wage Policy is meant to establish that link. Malaysia's industrial policies, including its New Industrial Master Plan,[11] should remain narrowly targeted to specific objectives where market solutions cannot deliver due to the presence of externalities or

[10] See appendix VIII in the 2022 Article IV CR 22/126 on climate mitigation and adaptation policies and appendix X in the 2023 Article IV CR 23/185 on getting Malaysia's financial system ready for climate change.

[11] See Appendix I for more details.

other market imperfections, consistent with WTO obligations, and should avoid discriminatory measures that distort trade and investment flows.

Malaysia: Wage Developments



35. The pandemic has put the spotlight on the exacerbated retirement income insecurity for a large proportion of Malaysians and while addressing low wages can help improve retirement income security, complementary policies are urgently needed. Notwithstanding good contribution rates, low wages entail low contributions, only 70 percent of which are earmarked for retirement. As of October 2023, only about 19 percent of total Employee Provident Fund (EPF) members aged 18 to 55 years old and 39 percent of active formal sector members in the same age group met the basic savings threshold. Basic savings by age is, a benchmark used by EPF to gauge the adequacy of retirement income, set at RM240,000, which is equivalent to a monthly retirement income of RM1,000 over a 20-year retirement period (which is below minimum wages). EPF initiatives, with government budget support, have successfully focused on incentivizing voluntary contributions, and on encouraging members to voluntarily shift to regular monthly payout rather than lump-sum withdrawals. Additional measures are needed. These include lengthening the savings' accumulation period by allowing retirement withdrawals only at retirement age (rather than at 55 currently), and by eventually gradually increasing the retirement age. They also include increasing the share of contributions dedicated to retirement/Account I, and in that respect the planned restructuring of EPF accounts announced in the 2024 Budget is welcome. Ensuring universal registration to address low coverage, while improving old-age safety net and providing employment opportunities for the older cohort, would also help ensure retirement and old age security (Appendix VIII).

36. It remains critical to see through governance and anti-corruption reforms and anchor them in legislation. The progress achieved on the implementation of the initiatives under the 2019-2023 National Anti-Corruption Plan (NACP) is welcome, but more needs to be done. Priority should be given to amending the 2010 Whistleblower Protection Act and beefing up the anticorruption legal framework with a view to expanding protection and disclosure avenues, ensuring the operational independence of anti-corruption institutions, and to reforming public procurement. In that respect, the announcement in the 2024 Budget speech of the planned tabling of the Procurement Bill in Parliament this year is welcome.

37. With a sizeable share of Malaysia's workers exposed to modern AI technologies, proactive labor policies are needed to leverage AI benefits while mitigating its risks (Appendix IX). The rapid progress in AI technologies is poised to transform economies, influencing the nature of work and the labor market. These technologies can enhance labor productivity but also pose risks of job displacement. To navigate this change, it is essential to identify which occupations are most exposed to AI. Following an approach developed in Felten et al. (2021), staff analysis finds that in Malaysia, around 39 percent of occupations are highly exposed to AI, with professionals facing the highest exposure while elementary occupations facing the least, although there is considerable variation within each occupational category. Proactive policy measures, including training, upskilling, and public awareness programs, particularly in sectors most exposed to AI, are required to leverage AI's benefits while mitigating its risks.

Authorities' Views

38. The authorities view their multifaceted structural policy agenda as pivotal to raising wages and ensuring retirement income security, and in turn achieving their aspiration of high-income status. They have finalized a strategy paper for the implementation of a voluntary and incentives-based productivity-linked Progressive Wage Policy (PWP), aimed at lifting median wages and targeting SMEs. With budget support providing incentives for employers to join in inception years, those participating in the PWP are expected to provide training that would increase employees' productivity and in turn their wages. A pilot project is planned for Q3 2024, and its performance will be reviewed before a comprehensive implementation plan for the PWP is finalized. The government has taken a firm stance on not allowing further pandemic-era withdrawals from EPF accounts, and the EPF is very cognizant of the long-stranding retirement insecurity which such withdrawals exacerbated. It is working on several complementary policy reform initiatives aimed at improving coverage, raising retirement savings, and ensuring their adequacy. The authorities are hopeful that their renewed focus on industrial policies through their New Industrial Master Plan (NIMP) 2030, amid a challenging geopolitical environment, will give Malaysia a second take-off, leveraging on its strategic location and strong human capital. They noted that a major objective of

NIMP 2030 is to increase economic complexity, and position Malaysia as a market leader in generative AI.

39. **The authorities highlighted their progress on governance reforms.** A new national strategy known as National Anti-Corruption Strategies (NACS) is in the making and is expected to be released in June 2024, as a continuation of the existing National Anti-Corruption Plan (NACP). Notwithstanding slow progress due to frequent government changes in recent years, work is ongoing on amending the Whistle Blower Protection Act. The authorities also noted that the insertion of corporate liability provision under the Malaysia Anti-Corruption Commission (MACC) Act which came into effect in June 2020 serves as a safeguard against transnational aspects of corruption and vulnerabilities related to bribery of public officials by multinational companies. They see the planned enactment of the Government Procurement Act in 2024 as timely to ensure efficiency and transparency, and thus maximize the return on public investment.

STAFF APPRAISAL

40. **Malaysia's growth has slowed.** And disinflation is taking hold. Malaysia's 2023 external position is preliminarily assessed to be stronger than warranted by fundamentals and desired policies.

41. **Downside risks, mostly external, cloud the near-term outlook.** External risks include the possibility of an abrupt global slowdown with an associated spike in global risk premia, capital outflows and sudden stops. Geoeconomic fragmentation, specifically fragmentation of commodity markets, could amplify commodity price volatility and negatively affect Malaysia's growth prospects.

42. **The fiscal consolidation strategy set out in the 2024 Budget is appropriate, but it should be credibly underpinned by high-quality and durable measures**. Staff welcome the historic passing of the Fiscal Responsibility Act, a major reform expected to enhance governance and transparency and improve accountability and fiscal responsibility. More clarity on the timeline of fuel price liberalization as well as on the details of the mechanism for targeted transfers to lower-income households are still needed. Domestic revenue mobilization remains an urgent priority to create space for the ambitious development spending needs under the multiple national strategy plans, and reinstating the GST can help Malaysia reach its tax potential.

43. **Monetary policy should maintain a tightening bias to manage upside risks to inflation.** This will ensure inflation expectations remain well anchored while also preserving space for monetary policy to respond to downside risks. Premature interest rate cuts should be avoided. Exchange rate flexibility and reserve adequacy should be preserved.

44. **The authorities' commitment to safeguarding financial stability is welcome.** Policies should seek to enhance monitoring of risks build-up due to high interest rates, and weakening of growth momentum, with particular attention to highly leveraged entities and smaller firms. The BNM should continue to update its stress test design to better capture emerging and rapidly evolving global risks.

45. Forging ahead with the implementation of the ambitious structural reform agenda is needed to support growth. The government faces the challenging task of implementing its well-crafted and concerted policy frameworks, which are appropriately focused on improving labor market outcomes and increasing incomes, addressing climate change, promoting digitalization, enhancing governance and reducing corruption vulnerabilities. Missing from the policy agenda is a clear action plan to ensure a sustainable pension system for an ageing population.

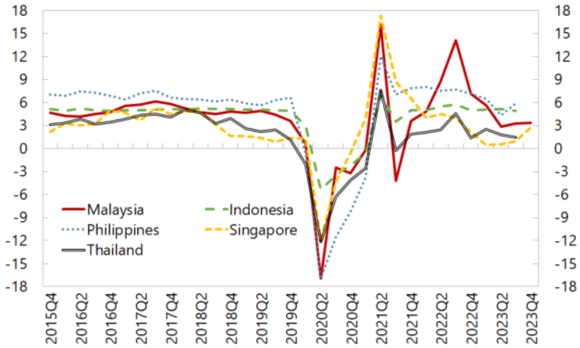
46. It is recommended that the Article IV consultation with Malaysia be held on the standard 12-months cycle.

Figure 1. Malaysia: Growth and Exports

Growth is moderating after peaking in 2022…

Real GDP Growth

(In y-o-y percent change)

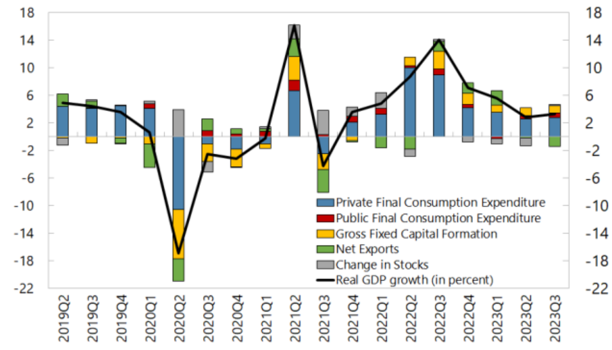


Sources: CEIC Data. Note: 2023 Q4 number for Malaysia is an advance estimate.

…still supported by resilient domestic demand.

Contributions to Real GDP Growth

(In percentage points, y-o-y)

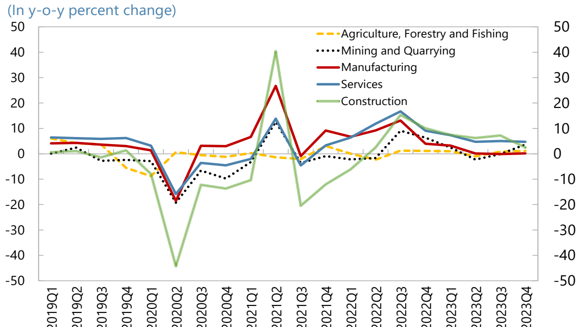


Sources: MYS Dept. of Statistics, Haver Analytics, and IMF staff calculations.

The slowdown has affected all industries, manufacturing in particular…

Real GDP by Industry

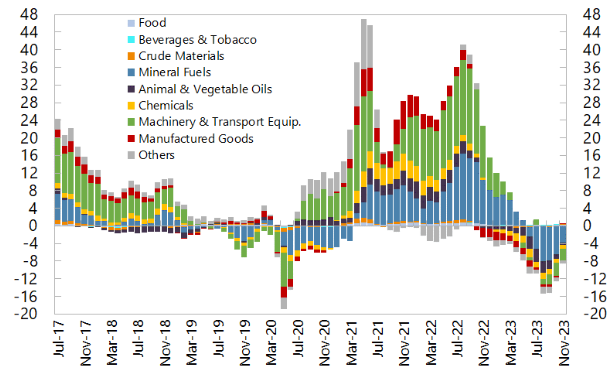
(In y-o-y percent change)



Sources: MYS Dept. of Statistics, Haver Analytics, and IMF staff calculations. Note: 2023 Q4 numbers are advance estimates.

…driven by slowing exports.

Contribution to Merchandise Export Growth

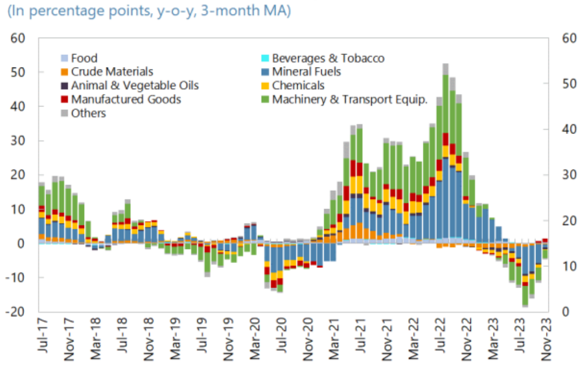


Sources: MYS Dept. of Statistics, Haver Analytics, and IMF staff

…with negative effects on imports of intermediate inputs.

Contribution to Merchandise Import Growth

(In percentage points, y-o-y, 3-month MA)

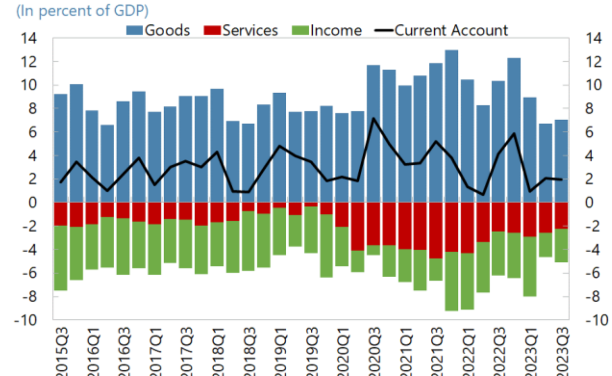


Sources: MYS Dept. of Statistics, Haver Analytics, and IMF staff calculations.

Malaysia's current account balance remains positive but is narrowing.

Current Account Balance

(In percent of GDP)



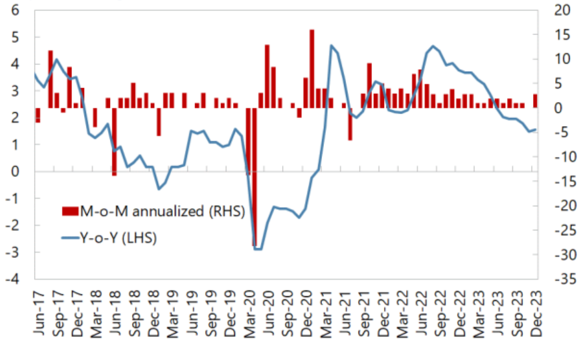
Sources: MYS Dept. of Statistics, CEIC Data, and IMF staff calculations.

Figure 2. Malaysia: Inflation and Domestic Resource Constraints

Inflation is moderating…

Consumer Price Index

(In percent change)

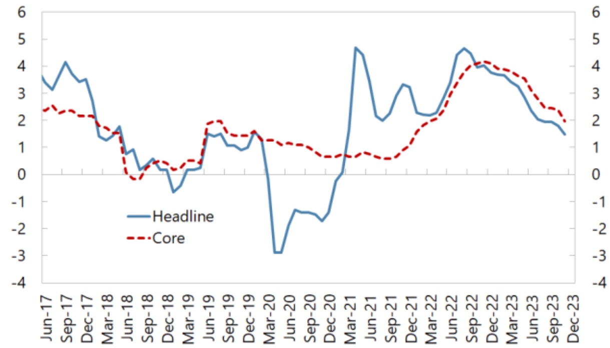


Sources: CEIC Data, MYS Dept. of Statistics, and IMF staff calculation.

…headline more rapidly than core.

Inflation Developments

(In y-o-y percent change)

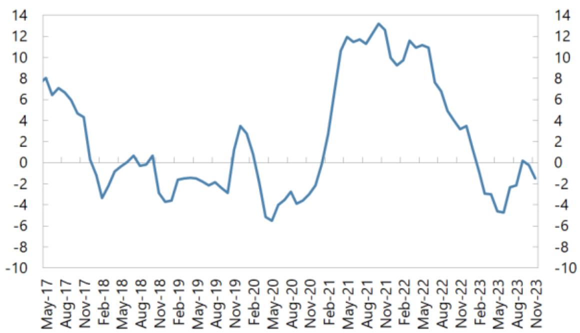


Sources: CEIC Data, MYS Dept. of Statistics, and IMF staff calculations.

Producer prices have significantly moderated.

Producer Price Index

(In y-o-y percent change)

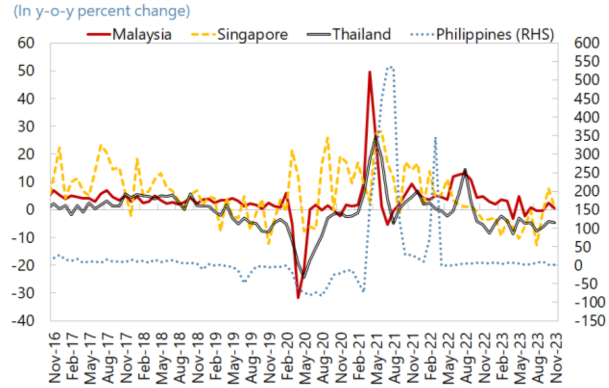


Sources: CEIC Data, and MYS Dept. of Statistics.

Industrial production remained strong relative to the region.

Industrial Production in Selected ASEAN Countries

(In y-o-y percent change)

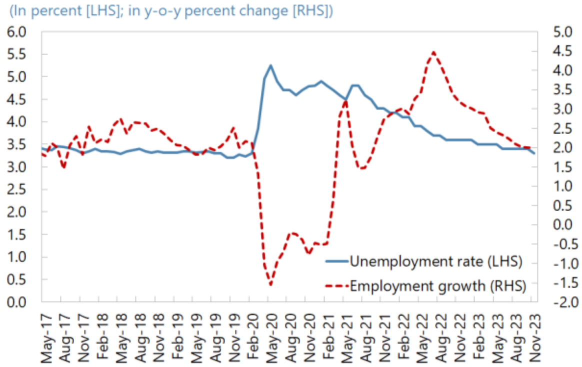


Sources: CEIC Data.

Unemployment rate is back to pre-pandemic levels.

Labor Market Developments

(In percent [LHS]; in y-o-y percent change [RHS])

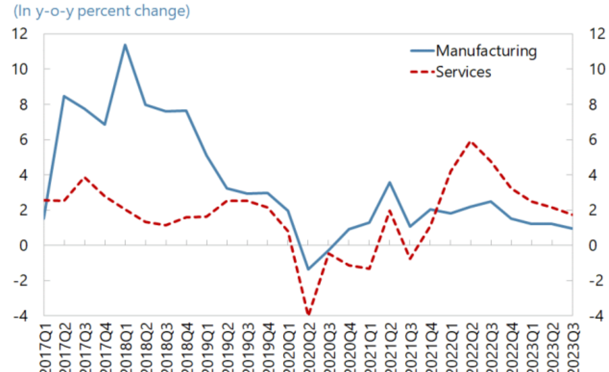


Sources: CEIC Data.

Wage growth has moderated after increasing in 2022.

Growth in Average Monthly Salary & Wages

(In y-o-y percent change)

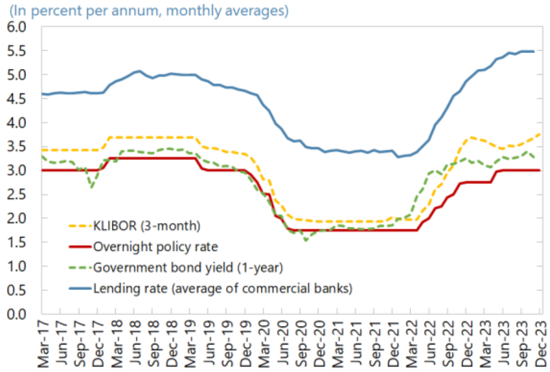


Sources: MYS Dept. of Statistics, Haver Analytics, and IMF staff calculation.

Figure 3. Malaysia: Monetary Developments

Monetary policy (based on the overnight policy rate) has remained on pause since May 2023…

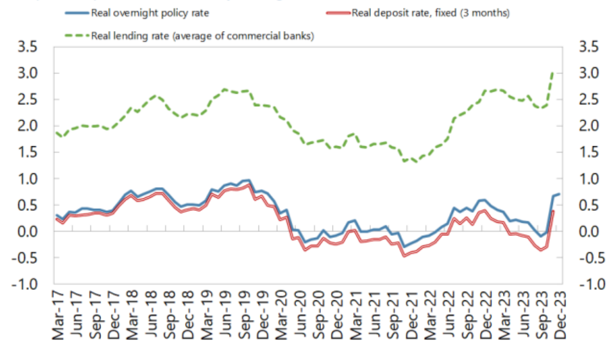
Interest Rates
(In percent per annum, monthly averages)



Sources: Bank Negara Malaysia and Haver Analytics.

…with real policy rate and real deposit rate becoming positive after being in negative territory.

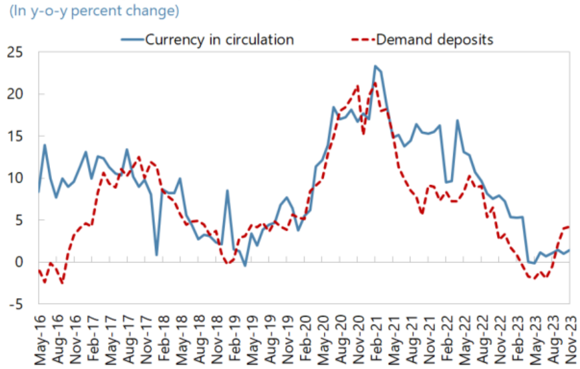
Real Interest Rates
(In percent per annum, monthly averages)



Note: Real rates are obtained by adjusting for inflation expectations of 1-year ahead.
Sources: Bank Negara Malaysia, Haver Analytics, Consesus Economics, and IMF staff calculations.

Demand deposits and currency in circulation have started to slightly pick up after a decline…

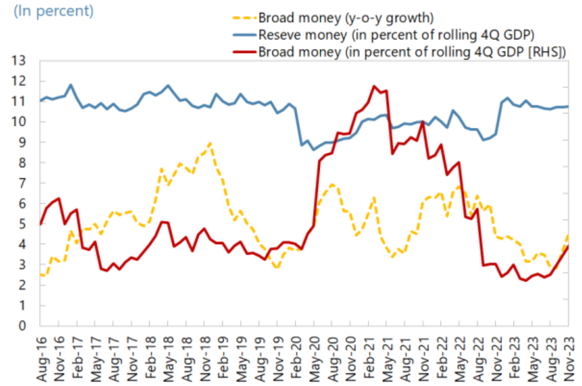
Demand Deposits and Currency in Circulation
(In y-o-y percent change)



Sources: Bank Negara Malaysia, CEIC Data, and IMF staff calculations.

…partly driving a slight pick-up in broad money growth.

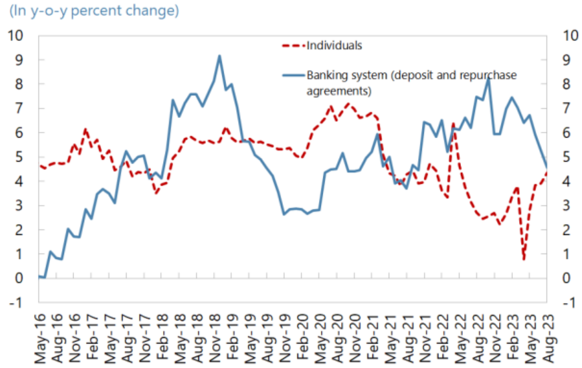
Monetary Aggregates at Depository Corporations level
(In percent)



Sources: Bank Negara Malaysia, MYS Dept. of Statistics, CEIC Data, and IMF staff calculations.

Individuals' deposit in the banking system picked up

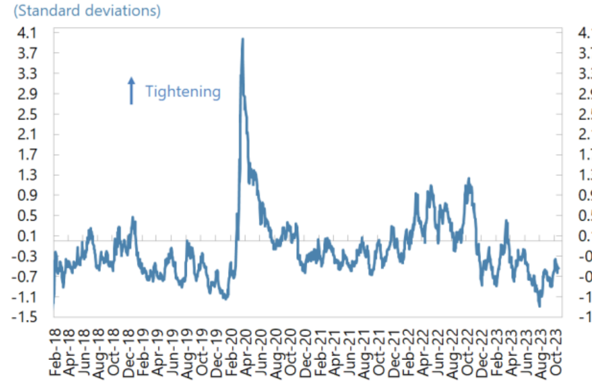
Banking System Deposit and Repurchase Agreement Growth
(In y-o-y percent change)



Sources: Bank Negara Malaysia, CEIC Data, and IMF staff calculations.

… while financial conditions have eased for most of 2023, as domestic inflation moderated and expectations of further BNM rate hikes have abated.

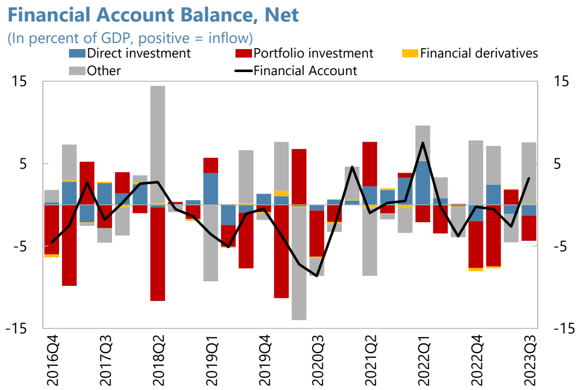
Daily Financial Conditions Index
(Standard deviations)



Sources: Bloomberg LP and IMF staff calculations.

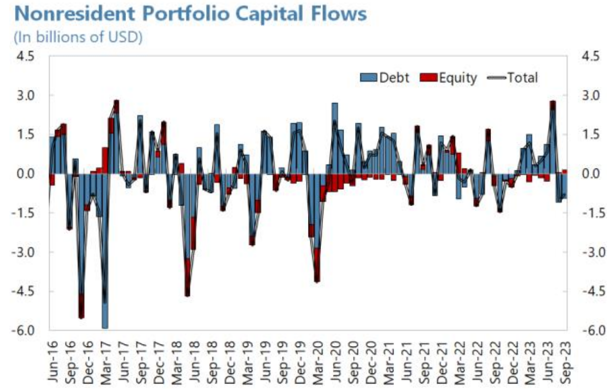
Figure 4. Malaysia: Capital Flows

Capital flowed outwards in the first half of 2023, reversing in Q3.



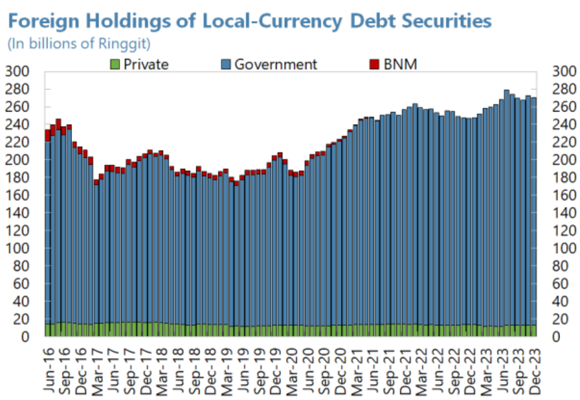
Sources: MYS Dept. of Statistics, CEIC Data, and IMF staff calculations.

Non-residents' holding of portfolio debt witnessed net inflows in 2023…



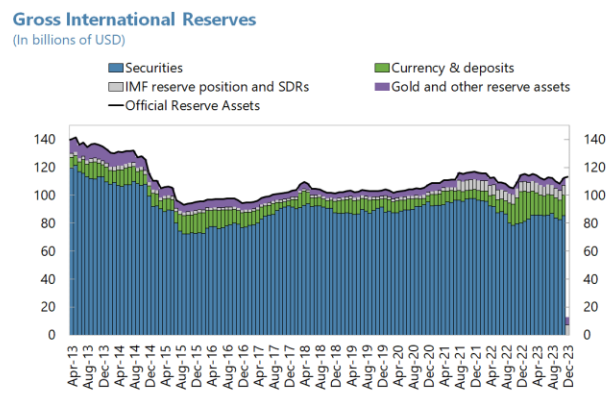
Note: Based on staff estimates from debt and equity markets data.
Sources: Bank Negara Malaysia, Bursa Malaysia, CEIC Data, and IMF staff calculations.

… leading to an increase in foreign holdings of ringgit-denominated government securities.



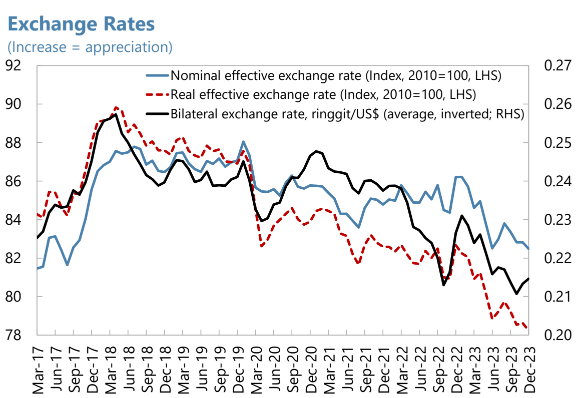
Sources: Bank Negara Malaysia, CEIC Data, and IMF staff calculations.

In the face of external pressures, BNM's gross FX reserves moderately declined in 2023.



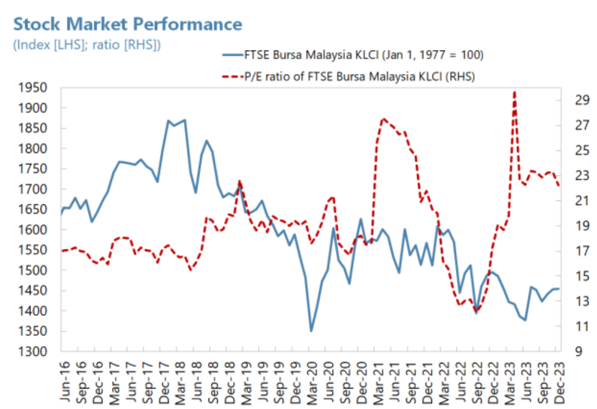
Sources: Bank Negara Malaysia, CEIC Data, and IMF staff calculations. Note: December 2023 numbers for securities and currency and deposits are not available yet.

Unlike last year, the weakening of the ringgit was broad-based during most of 2023.



Source: IMF, *International Financial Statistics*

The stock market remained volatile and closed in losses.

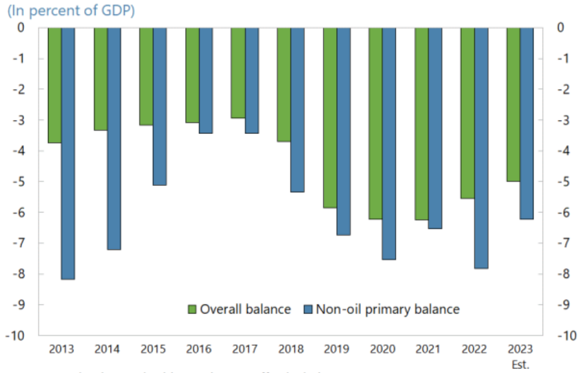


Sources: Bursa Malaysia and CEIC Data.

Figure 5. Malaysia: Fiscal Policy Developments

Following a large widening during the pandemic, the fiscal deficit is narrowing.

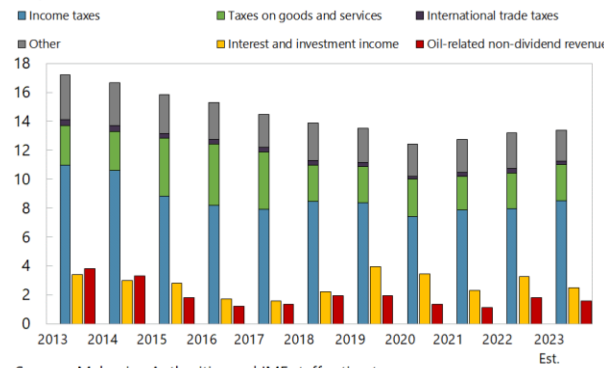
Federal Government: Overall and Non-Oil Balance
(In percent of GDP)



Sources: Malaysian Authorities and IMF staff calculations.

Total revenues to GDP ratio declined in 2023 on the back of lower petroleum-related revenues, despite strong tax collection.

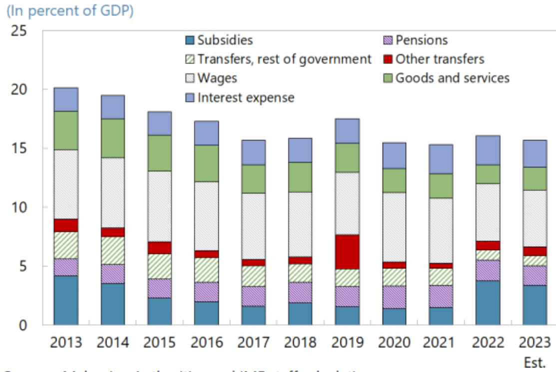
Federal Government Revenue
(In percent of GDP)



Sources: Malaysian Authorities and IMF staff estimates.

Current expenditures are projected to decline slightly in 2023 due in part to lower spending on subsidies

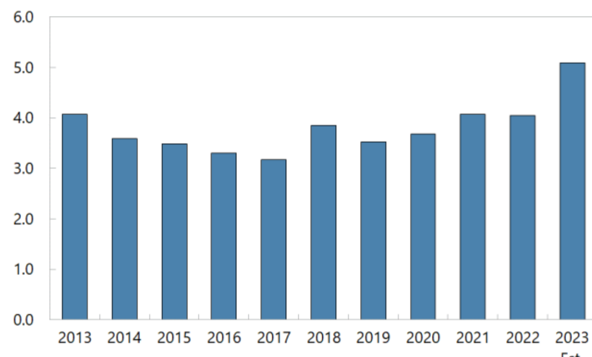
Federal Government Current Expenditures
(In percent of GDP)



Sources: Malaysian Authorities and IMF staff calculations.

The increase in development spending in 2023 was due to a large payment on a maturing 1MDB bond

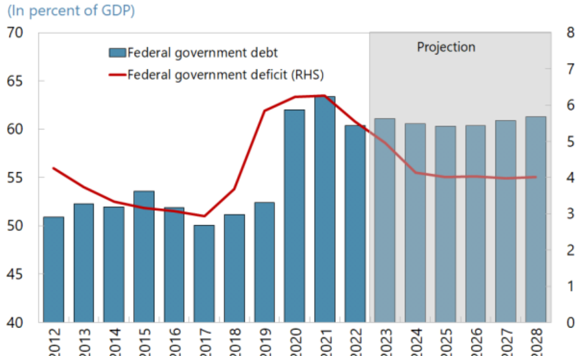
Federal Government Development Spending
(In percent of GDP)



Sources: Malaysian Authorities and IMF staff estimates.

A stable fiscal deficit is projected during 2025-2028.

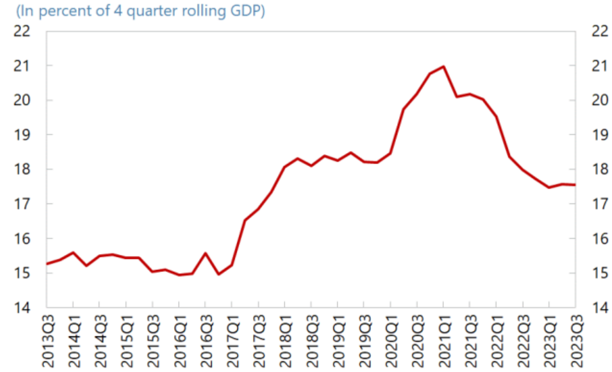
Medium–Term Fiscal Outlook
(In percent of GDP)



Sources: Malaysia Authorities and IMF staff estimates.

Government guarantees had been moderating

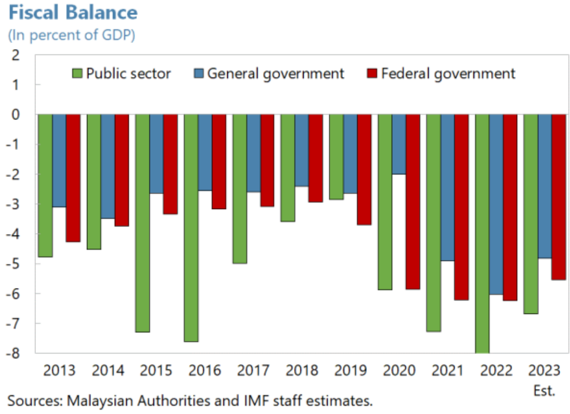
Federal Government Loan Guarantees
(In percent of 4 quarter rolling GDP)



Sources: Bank Negara Malaysia, CEIC Data, and IMF staff calculations.

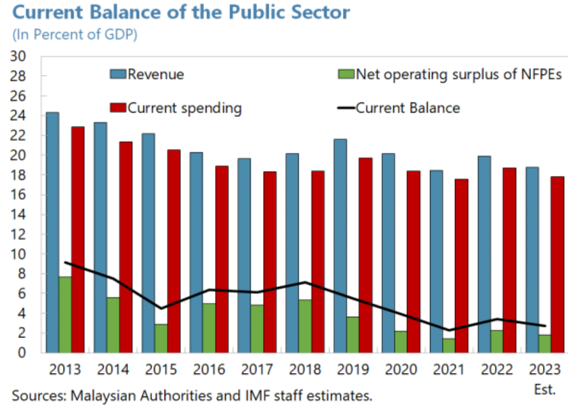
Figure 6. Malaysia: Public Sector Fiscal Stance and Prospects

The non-financial public sector deficit has been slightly improving



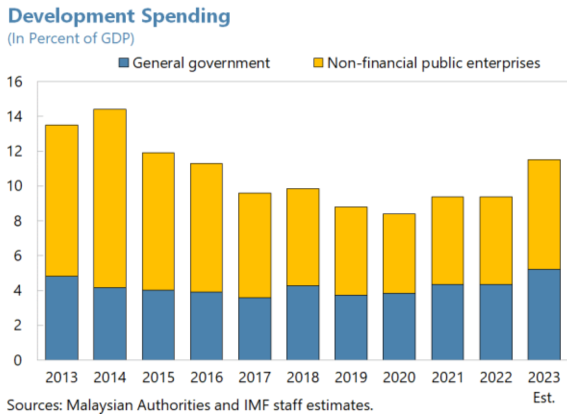
Sources: Malaysian Authorities and IMF staff estimates.

Public companies' surpluses have declined.



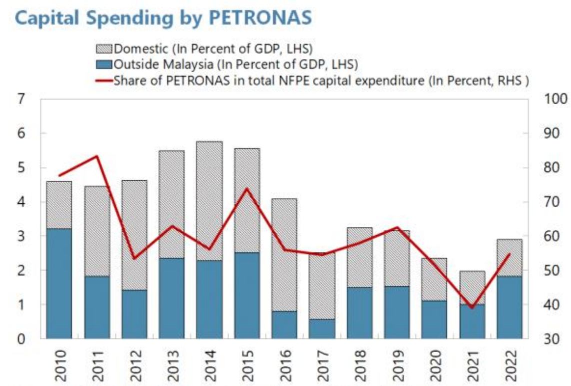
Sources: Malaysian Authorities and IMF staff estimates.

General government development spending has been increasing...



Sources: Malaysian Authorities and IMF staff estimates.

...with Petronas share lower than before



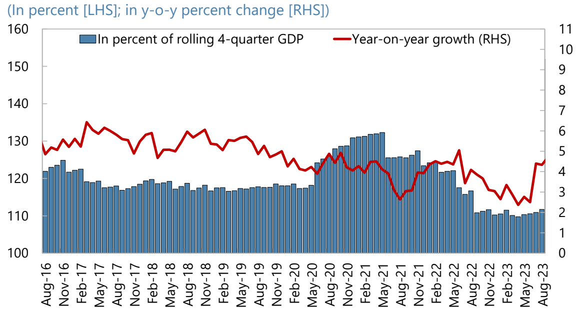
Sources: PETRONAS; Malaysian Authorities; and IMF staff calculations.

Figure 7. Malaysia: Financial Sector Developments

Credit to the private sector has picked up…

Bank Credit to Private Sector

(In percent [LHS]; in y-o-y percent change [RHS])

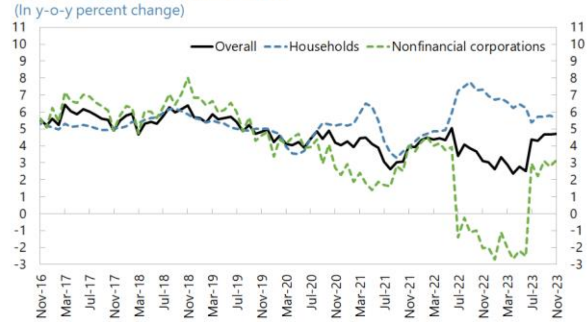


Note: The growth rates have been adjusted by staff to account for the re-classification of a non-bank to bank in April 2018.
Source: IMF, *Integrated Monetary Database*; MYS Dept. of Statistics; CEIC Data; & IMF staff calculations.

…supported by households.

Bank Credit to Private Sector

(In y-o-y percent change)

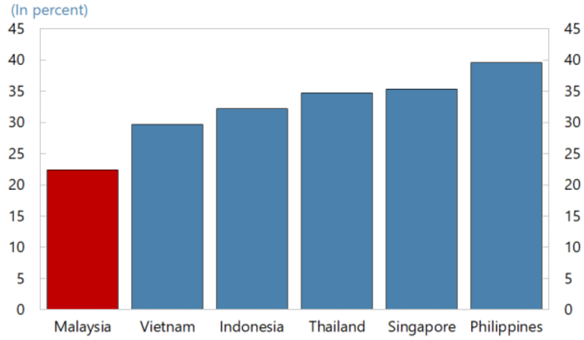


Note: The growth rates have been adjusted by staff to account for the re-classification of a non-bank to bank in April 2018.
Sources: IMF, *Integrated Monetary Database*; and IMF staff calculations.

Corporate leverage continues to compare favorably to peers.

Corporate Debt-to-Equity Ratio, 2022

(In percent)

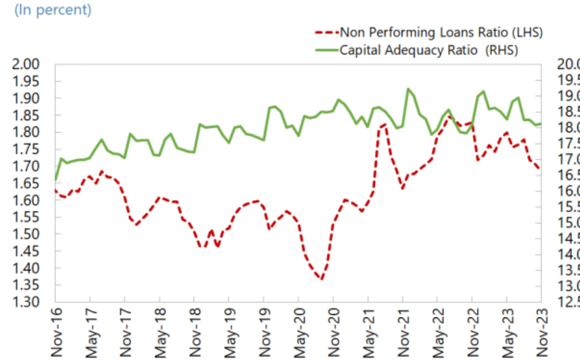


Note: Values presented are median values for nonfinancial sector.
Sources: IMF, *Corporate Vulnerability Indicators*.

The banking system remains well capitalized while non-performing loans have moderated and remain low.

Bank NPLs and Capital Buffers

(In percent)

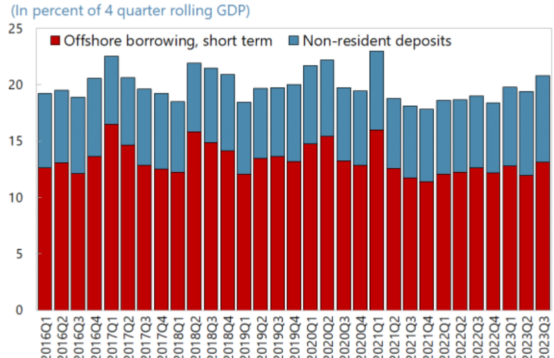


Sources: Bank Negara Malaysia and CEIC Data.

The banking system continues to rely on short-term external debt.

Bank Short Term Debt

(In percent of 4 quarter rolling GDP)

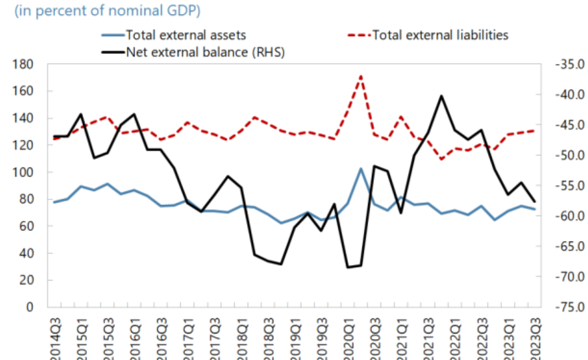


Sources: Bank Negara Malaysia, CEIC Data, and IMF staff calculations.

Banks' net external asset position remains weak.

Banking System: External Assets and Liabilities

(in percent of nominal GDP)

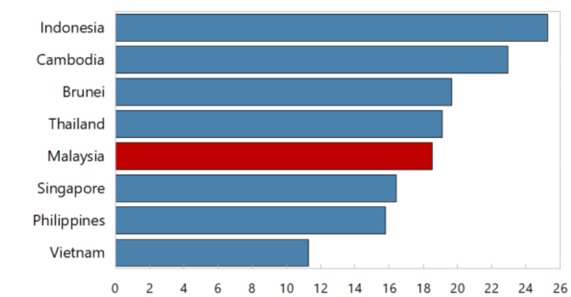


Sources: Bank Negara Malaysia, CEIC Data, and IMF staff calculations.

Figure 8. Malaysia: Financial Soundness Indicators

Malaysian banks remain with relatively strong capital buffers…

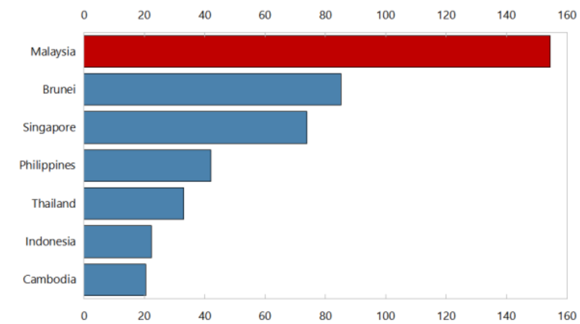
Regulatory Tier 1 Capital to Risk-Weighted Assets
(In percent)



Note: All except for Vietnam (2021Q4), Thailand (2023Q1), Singapore (2022Q3), and Philippines (2023Q1) as of 2023Q2.
Source: IMF, *Financial Soundness Indicators.*

…while liquidity continues to provide stronger cover for short-term liabilities relative to peers.

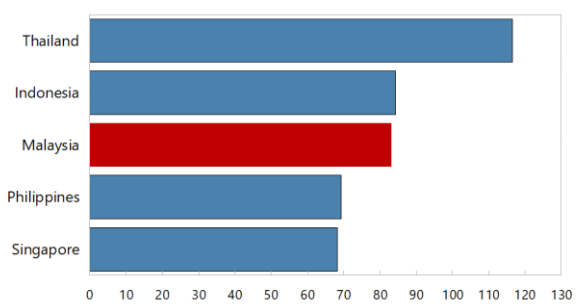
Liquid Assets to Short-Term Liabilities
(In percent)



Note: All except for Malaysia (2021Q3), Brunei (2023Q2), Philippines (2023Q1), Thailand (2023Q2), and Singapore (2019Q4) as of 2023Q3. Source: IMF, *Financial Soundness Indicators.*

Lending in proportion of deposits remains moderate and broadly in line with peers…

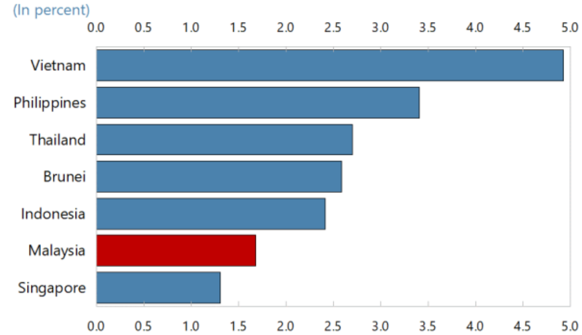
Loans to Deposits Ratio for Commercial Banks
(In percent, end of period)



Note: All except for Brunei (2023M09) and Indonesia (2022M10) as of 2023M11. Source: CEIC.

… and asset quality remains high.

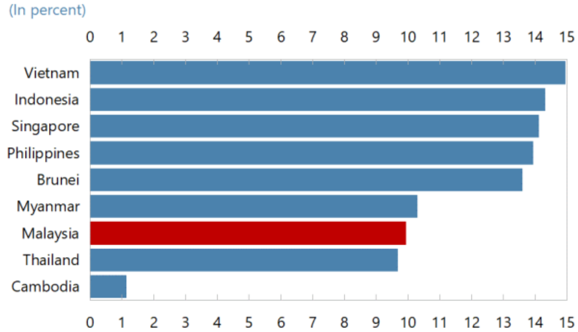
Nonperforming Loans to Total Gross Loans
(In percent)



Note: All except for Brunei (2023M03), Singapore (2023M11), and Thailand (2023M11) as of 2023M12. Source: IMF, *Financial Soundness Indicators.*

Banks remain profitable…

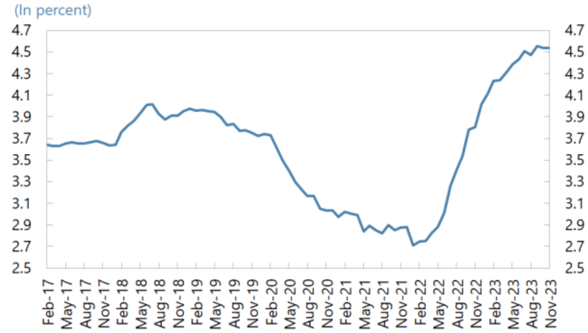
Return on Equity
(In percent)



Note: All except for Thailand (2023Q2), Brunei (2023Q2), Philippines (2023Q1), Singapore (2019Q4), Vietnam (2021Q4), and Myanmar (2022Q3) as of 2023Q3. Source: IMF, *Financial Soundness Indicators.*

…supported by lending activities amid some compression in interest margins due to higher funding costs.

Interest Rate Spreads for Commercial Banks
(In percent)

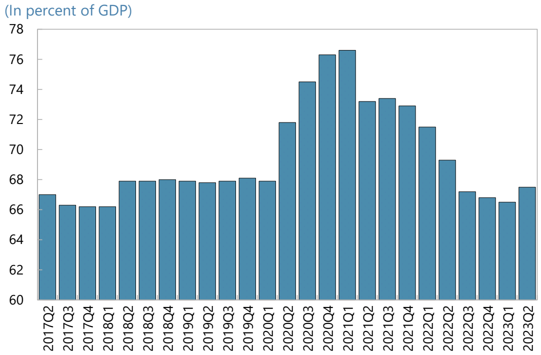


Note: The interest rate spread is defined as difference between the average lending rate and the average savings deposits rate.
Sources: Bank Negara Malaysia, CEIC Data, and IMF staff calculations.

Figure 9. Malaysia: Household Debt

Household debt (in the banking system) as share of GDP slightly increased as share of GDP…

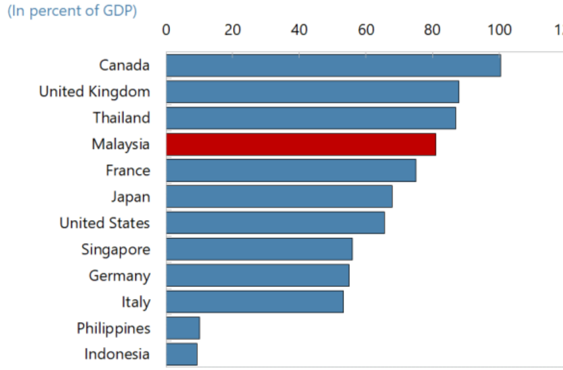
Household Debt
(In percent of GDP)



Sources: CEIC Data and Bank Negara Malaysia.

…and remains high compared to peers.

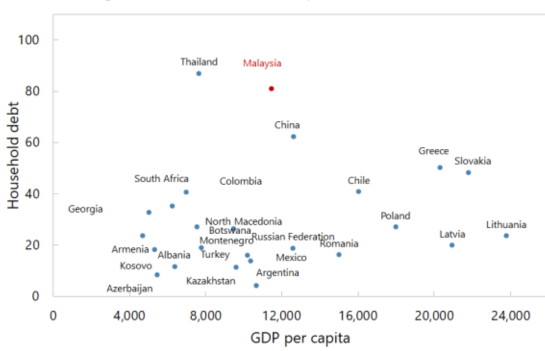
Household Debt Across G7 and ASEAN-5 Countries, 2022
(In percent of GDP)



Sources: CEIC Data, *Global Economic Monitor*.

… and above the levels observed in countries with similar GDP per capita.

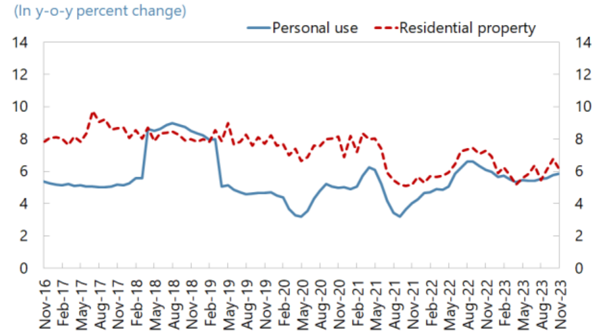
Household Debt and GDP per Capita
(2011-21 averages; in current USD [X axis]; in percent of GDP [Y axis])



Sources: CEIC Data, *Global Economic Monitor*.

Housing loans held up driven by both for personal use and housing

Household Loan Growth
(In y-o-y percent change)



Note: This chart is for household loan in the banking system only. Presented growth rates have been adjusted by staff to account for the re-classification of a non-bank to bank in April 2018.
Sources: CEIC Data, Bank Negara Malaysia (BNM), and IMF staff calculations.

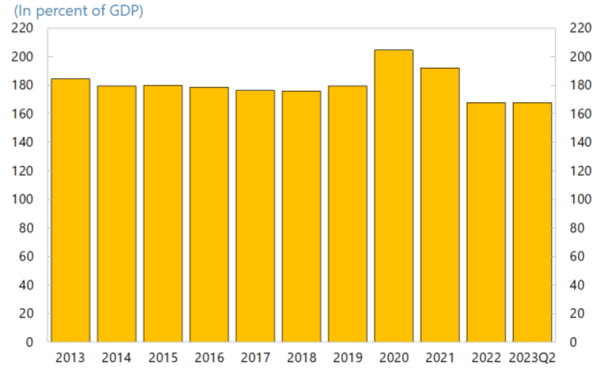
Household non-performing loans remain low but slightly above pre-pandemic level after exit from loan moratorium ..

Household Sector NPLs
(In percent of total loans to the household sector)

Sources: Bank Negara Malaysia, Haver Analytics, and IMF staff calculations.

… and household assets remained broadly stable.

Household Financial Assets
(In percent of GDP)

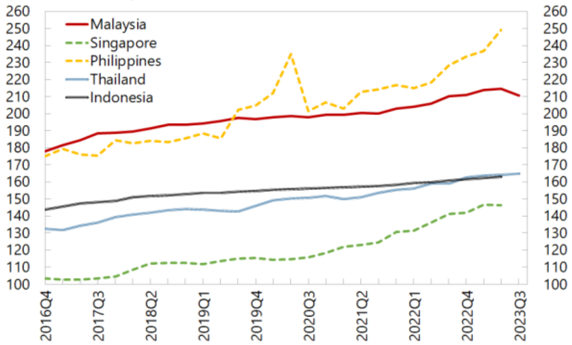


Sources: Bank Negara Malaysia, MYS Dept. of Statistics, Haver Analytics, & IMF staff calculation.

Figure 10. Malaysia: House Prices

House prices have remained broadly stable over recent years...

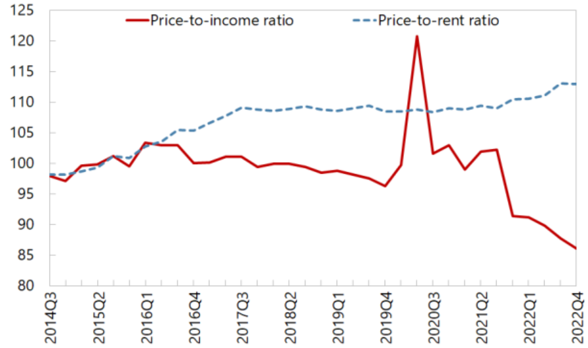
House Price Index
(Index, 2010 = 100)



Sources: Bank for International Settlements and CEIC Data.

... and also relative to rent but have been on a declining trend relative to income after the pandemic peak.

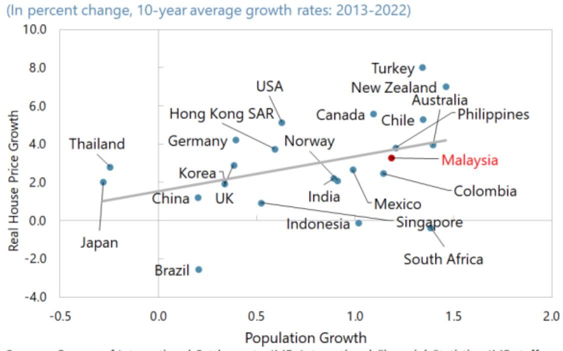
House Prices Relative to Rents and Income
(Index, 2015 = 100)



Sources: IMF, Research Dept. - "Real State Markets Module".

Strong population growth alone, cannot explain house price dynamics compared to other countries.

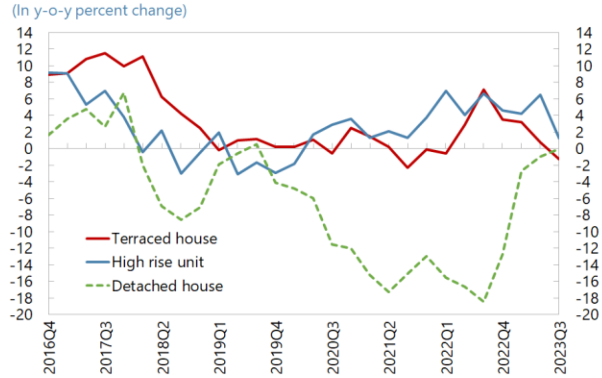
Real House Prices and Population Growth
(In percent change, 10-year average growth rates: 2013-2022)



Sources: Bureau of International Settlements; IMF, *International Financial Statistics*; IMF staff calculations.

House prices in Kuala Lumpur have moderated but shows a strong pickup in the detached house segment.

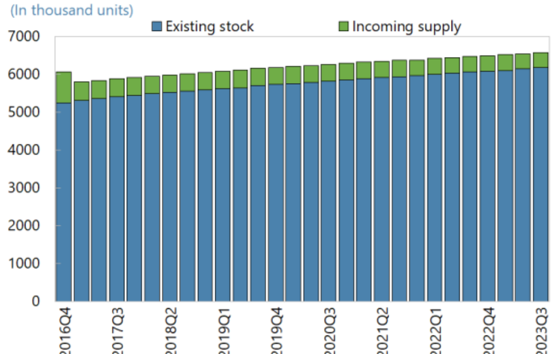
House Prices in Kuala Lumpur
(In y-o-y percent change)



Sources: MYS Ministry of Finance and IMF staff calculations.

Residential supply continued to increase...

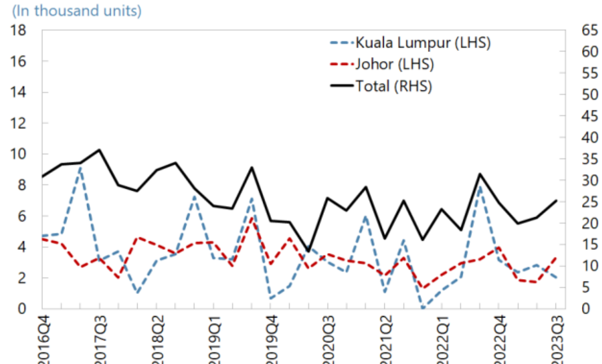
Residential Property Supply
(In thousand units)



Sources: MYS Ministry of Finance and IMF staff calculations.

... and construction started picked up..

Residential Property: Construction Started
(In thousand units)



Sources: MYS Ministry of Finance and IMF staff calculations.

Table 1. Malaysia: Selected Economic and Financial Indicators, 2019–29

Nominal GDP (2022): US$407.0 billion
GDP per capita (2022, current prices): US$12,466
Unemployment rate (2022, period average): 3.8 percent

Population (2022): 32.7 million
Poverty rate (2019, national poverty line): 0.2 percent
Adult literacy rate (2019): 95.0 percent

Main domestic goods exports (share of total domestic exports, 2022): Machinery and Transport Equipment (43.4 percent), Miscellaneous Manufactured Articles (10.5 percent), and Manufactured Goods (8.9 percent).

	2019	2020	2021	2022	Proj. 2023 Est. 1/	2024	2025	2026	2027	2028	2029
Real GDP (percent change)	4.4	-5.5	3.3	8.7	4.0	4.3	4.4	4.4	3.9	3.9	3.9
Total domestic demand	3.9	-4.8	3.8	9.3	4.3	4.0	4.2	4.2	3.8	3.7	3.7
Consumption	6.6	-2.6	2.7	9.9	5.6	5.0	3.9	4.1	3.6	3.6	3.5
Private consumption	7.7	-3.9	1.9	11.2	7.5	6.1	4.6	4.7	4.2	4.2	4.1
Public consumption	1.5	4.1	6.4	4.5	-3.3	-0.8	0.0	0.8	0.4	-0.5	-0.3
Private investment	1.6	-11.9	2.7	7.2	5.6	6.4	6.0	5.7	5.7	5.7	5.7
Public gross fixed capital formation	-10.7	-21.2	-11.1	5.3	-17.5	-8.7	1.6	-0.7	-2.1	-2.2	-2.3
Net exports (contribution to growth, percentage points)	0.7	-1.0	-0.3	-0.1	-0.1	0.5	0.5	0.4	0.4	0.4	0.5
Saving and investment (in percent of GDP)											
Gross domestic investment	21.0	19.7	22.1	23.5	24.0	23.5	24.0	24.0	23.7	23.8	23.8
Gross national saving	24.5	23.8	26.0	26.6	26.4	26.3	26.8	26.9	26.7	26.7	26.8
Fiscal sector (in percent of GDP) 2/											
Federal government overall balance	-3.4	-6.2	-6.4	-5.6	-5.0	-4.2	-4.2	-4.2	-4.2	-4.2	-4.2
Revenue	17.5	15.9	15.1	16.4	15.9	14.9	14.5	14.1	14.0	13.9	13.6
Expenditure and net lending	20.9	22.0	21.5	22.0	20.9	19.2	18.8	18.3	18.2	18.1	17.8
Tax refunds (Arrears)	2.4										
Federal government non-oil primary balance	-6.7	-5.0	-4.4	-6.2	-6.2	-4.8	-4.2	-3.6	-3.5	-3.3	-3.1
Consolidated public sector overall balance 3/	-3.4	-7.3	-8.3	-6.7	-7.9	-5.9	-5.8	-5.6	-5.7	-5.7	-5.7
General government debt 3/	57.1	67.7	69.2	65.6	66.8	66.6	66.5	66.8	67.8	68.7	69.4
Of which: federal government debt	52.4	62.0	63.3	60.3	61.5	61.2	61.2	61.5	62.5	63.3	64.1
Inflation and unemployment (annual average, in percent)											
CPI inflation	0.7	-1.1	2.5	3.4	2.5	2.9	2.5	2.2	1.9	1.9	1.9
CPI inflation (excluding food and energy)	1.1	1.1	0.7	3.0	3.0	3.1	2.0	2.0	2.0	2.0	2.0
Unemployment rate	3.3	4.5	4.7	3.8	3.6	3.5	3.5	3.5	3.5	3.5	3.5
Macrofinancial variables (end of period)											
Broad money (percentage change) 4/	2.4	4.9	5.6	4.0	6.6	7.9	7.5	6.7	5.6	5.7	5.7
Credit to private sector (percentage change) 4/	4.9	4.0	3.8	3.0	6.6	7.9	7.5	6.7	5.6	5.7	5.7
Credit-to-GDP ratio (in percent) 5/ 6/	130.5	144.8	137.6	122.6	122.6	122.6	122.6	122.6	122.6	122.6	122.6
Overnight policy rate (in percent)	3.00	1.75	1.75	2.75	...	...	...	...	...	...	...
Three-month interbank rate (in percent)	3.3	1.9	2.0	3.6	...	...	...	...	...	...	...
Nonfinancial corporate sector debt (in percent of GDP) 7/	99.2	109.7	108.9	97.6	...	...	...	...	...	...	...
Nonfinancial corporate sector debt issuance (in percent of GDP)	1.8	2.3	2.6	...	...	...	...	...	...	...	...
Household debt (in percent of GDP) 7/	82.8	93.1	88.9	81.0	...	...	...	...	...	...	...
Household financial assets (in percent of GDP) 7/	179.3	204.5	191.8	167.6	...	...	...	...	...	...	...
House prices (percentage change)	2.2	1.2	1.2	3.5	...	...	...	...	...	...	...
Exchange rates (period average)											
Malaysian ringgit/U.S. dollar	4.14	4.20	4.15	4.40	...	...	...	...	...	...	...
Real effective exchange rate (percentage change)	-1.3	-3.5	-1.3	-1.5	...	...	...	...	...	...	...
Balance of payments (in billions of U.S. dollars) 5/											
Current account balance	12.8	14.1	14.5	12.5	10.2	12.2	13.3	14.9	16.4	17.1	18.3
(In percent of GDP)	3.5	4.2	3.9	3.1	2.4	2.7	2.8	2.9	3.0	3.0	3.0
Goods balance	30.1	32.7	42.9	42.3	33.7	37.0	39.8	42.8	45.0	48.0	51.9
Services balance	-2.6	-11.2	-15.8	-12.8	-10.3	-10.8	-11.0	-10.8	-10.1	-10.8	-11.8
Income balance	-14.7	-7.4	-12.5	-16.9	-13.3	-14.0	-15.5	-17.2	-18.5	-20.0	-21.8
Capital and financial account balance	-9.1	-18.5	3.8	2.7	-11.3	-5.2	-1.9	-4.1	-5.2	-3.4	-9.9
Of which: Direct investment	1.6	0.7	7.5	3.6	2.7	3.5	3.8	4.0	4.2	4.4	4.7
Errors and omissions	-1.7	-0.1	-7.3	-3.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	2.0	-4.6	11.0	12.1	-1.2	6.9	11.5	10.8	11.2	13.8	8.4
Gross official reserves (US$ billions) 5/ 8/	103.6	107.6	116.9	114.7	113.5	120.4	131.9	142.6	153.8	167.6	176.0
(In months of following year's imports of goods and nonfactor services)	6.7	5.5	4.9	5.2	4.5	4.5	4.7	4.8	4.9	4.8	5.0
(In percent of short-term debt by original maturity)	108.9	117.6	120.8	105.1	91.9	90.7	89.7	88.3	87.8	87.0	86.1
(In percent of short-term debt by remaining maturity)	87.1	91.9	93.5	84.8	75.3	74.1	74.6	74.1	74.3	74.2	73.8
Total external debt (in billions of U.S. dollars) 5/ 8/	231.5	238.8	258.7	259.4	279.9	296.6	318.0	339.0	358.9	382.5	400.2
(In percent of GDP)	63.4	70.8	69.3	63.8	66.9	66.7	66.3	66.2	66.2	66.5	65.6
Of which: short-term (in percent of total, original maturity)	41.1	38.3	37.4	42.1	44.1	44.8	46.3	47.7	48.8	50.4	51.1
short-term (in percent of total, remaining maturity)	51.4	49.1	48.3	52.2	53.9	54.8	55.6	56.8	57.7	59.0	59.6
Debt service ratio 5/											
(In percent of exports of goods and services) 9/	10.9	13.6	10.5	9.7	11.3	11.9	12.0	11.3	10.7	10.4	10.1
(In percent of exports of goods and nonfactor services)	11.6	14.4	11.4	10.3	12.1	12.7	12.8	12.1	11.4	11.0	10.7
Memorandum items:											
Nominal GDP (in billions of ringgit)	1,513	1,418	1,549	1,791	1,910	2,061	2,215	2,365	2,496	2,638	2,788

Sources: Data provided by the authorities; CEIC Data; World Bank; UNESCO; and IMF, *Integrated Monetary Database*, and staff estimates.

1/ Data used in this report for staff analyses are as of January 30, 2024, unless otherwise noted. Official full year preliminary actual GDP is scheduled to be released on February 16th, 2024.

2/ Cash basis.

3/ Consolidated public sector includes general government and nonfinancial public enterprises (NFPEs). General government includes federal government, state and local governments, and statutory bodies.

4/ Based on data provided by the authorities, but follows compilation methodology used in IMF's *Integrated Monetary Database*. Credit to private sector in 2018 onwards includes data for a newly licensed commercial bank from April 2018. The impact of this bank is excluded in the calculation of credit gap.

5/ IMF staff estimates. U.S. dollar values are estimated using official data published in national currency.

6/ Based on a broader measure of liquidity. Credit gap is estimated on quarterly data from 2000, using one-sided Hodrick-Prescott filter with a large parameter.

7/ Revisions in historical data reflect the change in base year for nominal GDP (from 2010=100 to 2015=100).

8/ The decrease in short-term debt by remaining maturity in 2017 was partly due to the implementation of an improved data compilation system that corrected previous overestimation.

9/ Includes receipts under the primary income account.

Table 2. Malaysia: Indicators of External Vulnerability, 2019–23

	2019	2020	2021	2022	2023 1/
Financial indicators					
General government debt (in percent of GDP) 2/	57.1	67.7	69.2	65.6	66.8
Broad money (end of period, year-on-year percent change) 3/	2.4	4.9	5.6	4.0	6.6
Private sector credit (end of period, year-on-year percent change) 3/	4.9	4.0	3.8	3.0	6.6
3-month interest rate (percent, 12-month average) 4/	3.5	2.4	1.9	2.6	3.6
External indicators 5/					
Goods exports, f.o.b. (percent change, 12-month basis, in U.S. dollars terms) 6/	-4.1	-5.9	30.7	15.9	-12.1
Goods imports, f.o.b. (percent change, 12-month basis, in U.S. dollars terms) 6/	-5.7	-8.5	30.7	19.6	-10.7
Current account balance (12-month basis, in billions of U.S. dollars) 6/	12.8	14.1	14.5	12.5	10.2
Current account balance (12-month basis, in percent of GDP)	3.5	4.2	3.9	3.1	2.4
Capital and financial account balance (12-month basis, in billions of U.S. dollars) 6/	-9.1	-18.5	3.8	2.7	-11.3
Gross official reserves (in billions of U.S. dollars)	103.6	107.6	117.0	114.7	113.5
In months of following year's imports of goods and nonfactor services 6/	6.7	5.5	4.9	5.2	4.5
As percent of broad money 3/ 6/	22.9	22.2	23.8	23.7	23.2
As percent of monetary base 3/ 6/	271.9	270.7	298.2	314.9	387.6
Total short-term external debt by: 6/ 7/					
Original maturity (in billions of U.S. dollars)	95.2	91.5	96.8	109.1	123.6
Remaining maturity (in billions of U.S. dollars)	118.9	117.2	125.0	135.3	150.8
Original maturity to reserves (in percent)	91.9	85.0	82.7	95.2	108.9
Original maturity to total external debt (in percent)	41.1	38.3	37.4	42.1	44.1
Remaining maturity to reserves (in percent)	114.8	108.8	106.8	118.0	132.8
Remaining maturity to total external debt (in percent)	51.4	49.1	48.3	52.2	53.9
Total external debt (in billions of U.S. dollars) 6/ 7/	231.5	238.8	258.7	259.4	279.9
Of which: public sector (medium- and long-term (MLT))	76.0	85.6	94.7	84.3	90.3
Total external debt to exports of goods and services (in percent) 6/ 8/	91.1	108.4	90.0	77.8	90.7
External amortization of MLT debt to exports of goods and services (in percent) 6/ 8/	8.6	10.8	8.9	8.5	8.5
Financial market indicators					
Kuala Lumpur Composite Index (KLCI), end of period	1,589	1,627	1,568	1,495	
10-year government securities yield (percent per annum, average)	3.6	2.8	3.2	4.1	3.9

Sources: Haver Analytics; CEIC Data Co. Ltd.; data provided by the authorities; and IMF, *Integrated Monetary Database* and staff estimates.
1/ Latest available data or IMF staff estimates.
2/ Gross debt. General government includes the federal government, state and local governments, and the statutory bodies.
3/ Based on data provided by the authorities, but follows compilation methodology used in IMF's Integrated Monetary Database.
4/ Kuala Lumpur interbank offer rate.
5/ Based on balance of payments.
6/ IMF staff estimates. U.S. dollar values are estimated using official data published in national currency.
7/ Includes offshore borrowing, nonresident holdings of ringgit-denominated securities, nonresident deposits, and other short-term debt.
8/ Includes receipts under the primary income account.

Table 3. Malaysia: Balance of Payments, 2019–29 1/

								Proj.			
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					(In billions of U.S. dollars)						
Current account balance	12.8	14.1	14.5	12.5	10.2	12.2	13.3	14.9	16.4	17.1	18.3
Goods balance	30.1	32.7	42.9	42.3	33.7	37.0	39.8	42.8	45.0	48.0	51.9
Exports, f.o.b.	197.3	185.7	242.8	281.3	247.2	280.9	298.8	314.8	332.7	352.6	375.1
Imports, f.o.b.	167.2	153.0	199.9	239.1	213.5	243.9	259.0	272.0	287.7	304.6	323.2
Services balance	-2.6	-11.2	-15.8	-12.8	-10.3	-10.8	-11.0	-10.8	-10.1	-10.8	-11.8
Receipts	41.1	22.1	21.3	31.9	40.4	46.1	50.7	54.6	59.0	63.2	68.0
Payments	43.7	33.3	37.1	44.7	50.7	56.9	61.7	65.4	69.1	74.0	79.8
Primary income	-9.5	-6.8	-10.2	-13.5	-9.5	-9.5	-10.3	-11.0	-11.7	-12.8	-14.2
Secondary income	-5.2	-0.6	-2.3	-3.4	-3.8	-4.5	-5.3	-6.2	-6.8	-7.2	-7.6
Capital and financial account balance	-9.1	-18.5	3.8	2.7	-11.3	-5.2	-1.9	-4.1	-5.2	-3.4	-9.9
Capital account	0.1	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	-9.2	-18.4	3.9	2.8	-11.3	-5.2	-1.9	-4.1	-5.2	-3.4	-9.9
Direct investment	1.6	0.7	7.5	4.0	2.7	3.5	3.8	4.0	4.2	4.4	4.7
Portfolio investment	-7.8	-11.8	4.5	-11.5	-6.7	-4.0	-7.4	-9.3	-10.1	-10.7	-10.9
Other investment	-3.0	-7.4	-8.1	10.3	-7.4	-4.8	1.8	1.2	0.7	2.9	-3.7
Errors and omissions	-1.7	-0.1	-7.3	-3.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	2.0	-4.6	11.0	12.1	-1.2	6.9	11.5	10.8	11.2	13.8	8.4
Gross official reserves	103.6	107.6	116.9	114.7	113.5	120.4	131.9	142.6	153.8	167.6	176.0
In months of following year's imports of goods and nonfactor services	6.7	5.5	4.9	5.2	4.5	4.5	4.7	4.8	4.9	4.8	5.0
In percent of short-term debt 2/	87.1	91.9	93.5	84.8	75.3	74.1	74.6	74.1	74.3	74.2	73.8
					(In percent of GDP)						
Current account balance	3.5	4.2	3.9	3.1	2.4	2.7	2.8	2.9	3.0	3.0	3.0
(Excluding crude oil and liquefied natural gas)	0.8	2.2	1.3	0.6	1.3	1.2	1.2	1.3	1.4	1.4	1.4
Goods balance	8.2	9.7	11.5	10.4	8.0	8.3	8.3	8.3	8.3	8.3	8.5
Exports, f.o.b.	54.0	55.0	64.9	69.1	59.0	63.0	62.2	61.3	61.3	61.2	61.4
Imports, f.o.b.	45.8	45.3	53.5	58.7	51.0	54.7	53.9	53.0	53.0	52.9	52.9
Services balance	-0.7	-3.3	-4.2	-3.1	-2.5	-2.4	-2.3	-2.1	-1.9	-1.9	-1.9
Primary income	-2.6	-2.0	-2.7	-3.3	-2.3	-2.1	-2.1	-2.1	-2.2	-2.2	-2.3
Secondary income	-1.4	-0.2	-0.6	-0.8	-0.9	-1.0	-1.1	-1.2	-1.3	-1.3	-1.3
Capital and financial account balance	-2.5	-5.5	1.0	0.7	-2.7	-1.2	-0.4	-0.8	-1.0	-0.6	-1.6
Direct investment	0.4	0.2	2.0	1.0	0.7	0.8	0.8	0.8	0.8	0.8	0.8
					(Annual percentage change)						
Memorandum items:											
Goods trade											
Exports, f.o.b., value growth (in U.S. dollars) 1/	-4.1	-5.9	30.7	15.9	-12.1	13.6	6.4	5.3	5.7	6.0	6.4
Export volume growth 3/	-1.6	1.4	14.5	6.6	0.2	4.4	3.9	3.7	3.6	3.4	3.2
Imports, f.o.b., value growth (in U.S. dollars) 1/	-5.7	-8.5	30.7	19.6	-10.7	14.2	6.2	5.0	5.8	5.9	6.1
Import volume growth 3/	-3.2	-2.8	18.6	19.2	3.0	4.6	4.2	4.1	3.9	3.8	3.8
Terms of trade	1.1	0.6	6.0	6.6	1.5	-0.4	0.4	0.7	0.1	0.6	0.8
Net international investment position 1/											
(In billions of U.S. dollars)	-9.5	20.1	21.5	12.3	...	...	...	...	...	...	...
(In percent of GDP)	-2.6	5.7	5.8	3.0	...	...	...	...	...	...	...

Sources: Data provided by the authorities; and IMF staff estimates.

1/ Information presented in this table is based on staff estimates using official data published in national currency.
2/ Based on IMF staff estimates of short-term external debt by remaining maturity.
3/ Export and import volume growth in 2015-2018 is calculated using official export and import volume indices (2010=100).

Table 4. Malaysia: Medium-Term Macroeconomic Framework, 2019–29 1/

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Est. 2/	Proj.					
Real sector (percent change)											
Real GDP growth	4.4	-5.5	3.3	8.7	4.0	4.3	4.4	4.4	3.9	3.9	3.9
Total domestic demand	3.9	-4.8	3.8	9.3	4.3	4.0	4.2	4.2	3.8	3.7	3.7
Of which: Private consumption	7.7	-3.9	1.9	11.2	7.5	6.1	4.6	4.7	4.2	4.2	4.1
Public consumption	1.5	4.1	6.4	4.5	-3.3	-0.8	0.0	0.8	0.4	-0.5	-0.3
Private investment	1.6	-11.9	2.7	7.2	5.6	6.4	6.0	5.7	5.7	5.7	5.7
Public gross fixed capital formation	-10.7	-21.2	-11.1	5.3	-17.5	-8.7	1.6	-0.7	-2.1	-2.2	-2.3
Output gap (in percent) 3/	0.1	-3.9	-3.3	1.2	0.8	0.8	0.8	0.8	0.4	0.0	0.0
Consumer prices (period average)	0.7	-1.1	2.5	3.4	2.5	2.9	2.5	2.2	1.9	1.9	1.9
Consumer prices, excluding food and energy (period average) 3/	1.1	1.1	0.7	3.0	3.0	3.1	2.0	2.0	2.0	2.0	2.0
GDP deflator	0.1	-0.8	5.7	6.4	2.5	3.5	2.9	2.2	1.6	1.7	1.7
Saving and investment (in percent of GDP)											
Gross domestic investment	21.0	19.7	22.1	23.5	24.0	23.5	24.0	24.0	23.7	23.8	23.8
Private, including stocks	14.8	14.4	17.8	19.5	20.7	20.6	21.2	21.2	21.1	21.3	21.4
Of which: gross fixed capital formation	16.7	15.7	14.9	14.2	15.7	16.0	16.4	16.8	17.4	18.0	18.6
Public	6.2	5.2	4.3	4.0	3.3	2.9	2.8	2.7	2.6	2.5	2.4
Gross national saving	24.5	23.8	26.0	26.6	26.4	26.3	26.8	26.9	26.7	26.7	26.8
Private 4/	19.0	19.9	23.7	23.1	23.6	22.7	23.4	23.5	23.5	23.4	23.5
Public 4/	5.6	3.9	2.3	3.4	2.8	3.6	3.4	3.4	3.3	3.3	3.3
Fiscal sector (in percent of GDP)											
Federal government											
Revenue	17.5	15.9	15.1	16.4	15.9	14.9	14.5	14.1	14.0	13.9	13.6
Tax	11.9	10.9	11.2	11.7	12.0	11.8	11.7	11.6	11.5	11.5	11.5
Nontax	5.5	5.0	3.9	4.8	3.9	3.1	2.8	2.5	2.5	2.4	2.1
Expenditure and net lending	20.9	22.0	21.5	22.0	20.9	19.2	18.8	18.3	18.2	18.1	17.8
Current	17.4	18.2	17.3	17.9	15.7	14.7	14.4	14.0	14.0	13.9	13.6
Development	3.5	3.8	4.3	4.1	5.1	4.5	4.3	4.2	4.2	4.2	4.2
Overall balance	-3.4	-6.2	-6.4	-5.6	-5.0	-4.2	-4.2	-4.2	-4.2	-4.2	-4.2
Cyclically-adjusted balance (in percent of potential GDP) 3/	-5.3	-2.3	-3.6	-4.3	-4.5	-4.3	-4.4	-4.3	-4.3	-4.2	-4.2
Nonoil and gas primary balance	-6.7	-5.0	-4.4	-6.2	-6.2	-4.8	-4.2	-3.6	-3.5	-3.3	-3.1
Federal government debt	52.4	62.0	63.3	60.3	61.5	61.2	61.2	61.5	62.5	63.3	64.1
Balance of payments (in billions of U.S. dollars) 3/											
Goods balance	30.1	32.7	42.9	42.3	33.7	37.0	39.8	42.8	45.0	48.0	51.9
Services balance	-2.6	-11.2	-15.8	-12.8	-10.3	-10.8	-11.0	-10.8	-10.1	-10.8	-11.8
Income balance	-14.7	-7.4	-12.5	-16.9	-13.3	-14.0	-15.5	-17.2	-18.5	-20.0	-21.8
Current account balance	12.8	14.1	14.5	12.5	10.2	12.2	13.3	14.9	16.4	17.1	18.3
(In percent of GDP)	3.5	4.2	3.9	3.1	2.4	2.7	2.8	2.9	3.0	3.0	3.0
Capital and financial account balance	-9.1	-18.5	3.8	2.7	-11.3	-5.2	-1.9	-4.1	-5.2	-3.4	-9.9
Of which : Direct investment	1.6	0.7	7.5	3.6	2.7	3.5	3.8	4.0	4.2	4.4	4.7
Errors and omissions	-1.7	-0.1	-7.3	-3.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	2.0	-4.6	11.0	12.1	-1.2	6.9	11.5	10.8	11.2	13.8	8.4
International trade in goods (annual percent change) 3/											
Goods exports, f.o.b. (in U.S. dollars terms)	-4.1	-5.9	30.7	15.9	-12.1	13.6	6.4	5.3	5.7	6.0	6.4
Goods imports, f.o.b. (in U.S. dollars terms)	-5.7	-8.5	30.7	19.6	-10.7	14.2	6.2	5.0	5.8	5.9	6.1
Terms of trade	1.1	0.6	6.0	6.6	1.5	-0.4	0.0	0.7	0.1	0.6	0.8
Gross official reserves (in billions of U.S. dollars) 4/	103.6	107.6	116.9	114.7	113.5	120.4	131.9	142.6	153.8	167.6	176.0
(In months of following year's imports of goods and nonfactor services)	6.7	5.5	4.9	5.2	4.5	4.5	4.7	4.8	4.9	4.8	5.0
(In percent of short-term debt by original maturity) 3/	108.9	117.6	120.8	105.1	91.9	90.7	89.7	88.3	87.8	87.0	86.1
(In percent of short-term debt by remaining maturity) 3/	87.1	91.9	93.5	84.8	75.3	74.1	74.6	74.1	74.3	74.2	73.8
Total external debt (in billions of U.S. dollars) 3/ 4/	231.5	238.8	258.7	259.4	279.9	296.6	318.0	339.0	358.9	382.5	400.2
(In percent of GDP)	63.4	70.8	69.2	63.7	66.8	66.6	66.2	66.1	66.1	66.4	65.5
Short-term external debt (percent of total, original maturity)	41.1	38.3	37.4	42.1	44.1	44.8	46.3	47.7	48.8	50.4	51.1
Short-term external debt (percent of total, remaining maturity)	51.4	49.1	48.3	52.2	53.9	54.8	55.6	56.8	57.7	59.0	59.6
Debt-service ratio 3/ 4/											
(In percent of exports of goods and nonfactor services)	11.6	14.4	11.4	10.3	12.1	12.7	12.8	12.1	11.4	11.0	10.7
Net international investment position (in billions of U.S. dollars) 3/	-9.5	20.1	21.5	12.3	...	...	...	...	...	...	...
Memorandum items:											
Nominal GDP (in billions of ringgit)	1,513	1,418	1,549	1,791	1,910	2,061	2,215	2,365	2,496	2,638	2,788

Sources: Data provided by the authorities; and IMF staff estimates.

1/ Period ending December 31.

2/ Data used in this report for staff analyses are as of January 30, 2024, unless otherwise noted. Official full year preliminary actual GDP is scheduled to be released on February 16th, 2024."

3/ IMF staff estimates. U.S. dollar values are estimated using the official data published in national currency.

4/ The decrease in short-term debt by remaining maturity in 2017 was partly due to the implementation of an improved data compilation system that corrected previous overestimation.

Table 5. Malaysia: Summary of Federal Government Operations and Stock Positions, 2019–29

				Proj.							
	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
I. Statement of Government Operations 1/					(In billions of ringgit)						
Revenue	264.4	225.1	233.8	294.4	303.2	307.6	322.0	333.9	348.9	366.5	380.2
Taxes	180.6	154.4	173.7	208.8	229.0	243.6	258.9	274.2	287.7	303.6	320.6
Direct taxes	134.7	112.5	130.1	153.5	173.0	185.0	196.6	207.9	217.7	229.6	242.5
Indirect taxes	45.8	41.9	43.6	55.3	56.0	58.6	62.3	66.3	70.0	74.0	78.1
Non-tax revenue	83.8	70.7	60.0	85.6	74.2	64.0	63.1	59.8	61.2	62.9	59.6
Investment income	60.1	46.1	35.0	58.2	47.8	39.7	37.6	33.1	33.5	34.0	29.5
Other revenue	23.8	24.6	25.0	27.4	26.4	24.3	25.5	26.7	27.7	28.9	30.1
Expenditure and net lending	316.0	312.7	333.1	394.3	398.4	394.7	415.6	432.2	454.5	477.8	497.4
Current expenditure, including COVID fund	262.6	258.4	267.2	320.9	299.2	302.1	320.0	332.2	349.0	366.3	379.5
Expense	262.6	223.3	230.9	291.6	299.2	302.1	320.0	332.2	349.0	366.3	379.5
Compensation of employees	80.5	83.0	85.9	87.8	91.3	95.6	102.0	108.7	115.9	121.0	126.4
Use of goods and services	31.5	29.3	24.9	34.7	34.0	38.0	38.6	41.2	43.9	46.8	49.9
Interest	32.9	34.5	38.1	41.3	46.1	49.8	59.7	65.6	71.3	76.8	76.3
Subsidies and social assistance	23.9	19.8	23.0	67.4	64.2	52.8	52.3	45.9	43.7	40.3	41.3
Grants and transfers	66.0	28.9	29.1	28.6	31.1	32.9	32.8	33.9	35.0	39.5	41.0
Social benefits and other expense	27.7	27.9	29.9	31.9	32.5	33.0	34.6	36.9	39.3	41.9	44.7
COVID fund 2/		35.1	36.3	29.3	0.0						
Wage subsidies		13.0	9.0	2.3							
Social transfers		16.2	15.9	7.9							
Other spending		6.0	11.4	19.1							
Net acquisition of nonfinancial assets (incl. COVID spending) 3/	53.3	54.3	65.9	73.4	98.1	92.6	95.6	100.0	105.5	111.5	117.9
Gross operating balance	1.8	1.7	2.8	2.7	4.0	5.5	1.9	1.7	-0.1	0.1	0.7
Net lending/borrowing 1/	-51.5	-87.6	-99.3	-99.9	-95.2	-87.1	-93.6	-98.2	-105.6	-111.4	-117.2
					(In percent of GDP)						
Revenue	17.5	15.9	15.1	16.4	15.9	14.9	14.5	14.1	14.0	13.9	13.6
Taxes	11.9	10.9	11.2	11.7	12.0	11.8	11.7	11.6	11.5	11.5	11.5
Direct taxes	8.9	7.9	8.4	8.6	9.1	9.0	8.9	8.8	8.7	8.7	8.7
Indirect taxes	3.0	3.0	2.8	3.1	2.9	2.8	2.8	2.8	2.8	2.8	2.8
Non-tax revenue	5.5	5.0	3.9	4.8	3.9	3.1	2.8	2.5	2.5	2.4	2.1
Investment income	4.0	3.2	2.3	3.3	2.5	1.9	1.7	1.4	1.3	1.3	1.1
Other revenue	1.6	1.7	1.6	1.5	1.4	1.2	1.2	1.1	1.1	1.1	1.1
Expenditure and net lending	20.9	22.0	21.5	22.0	20.9	19.2	18.8	18.3	18.2	18.1	17.8
Current expenditure, including COVID fund	17.4	18.2	17.3	17.9	15.7	14.7	14.4	14.0	14.0	13.9	13.6
Expense	17.4	15.7	14.9	16.3	15.7	14.7	14.4	14.0	14.0	13.9	13.6
Compensation of employees	5.3	5.9	5.5	4.9	4.8	4.6	4.6	4.6	4.6	4.6	4.5
Use of goods and services	2.1	2.1	1.6	1.9	1.8	1.8	1.7	1.7	1.8	1.8	1.8
Interest	2.2	2.4	2.5	2.3	2.4	2.4	2.7	2.8	2.9	2.9	2.7
Subsidies and social assistance	1.6	1.4	1.5	3.8	3.4	2.6	2.4	1.9	1.7	1.5	1.5
Grants and transfers	4.4	2.0	1.9	1.6	1.6	1.6	1.5	1.4	1.4	1.5	1.5
Social benefits and other expense	1.8	2.0	1.9	1.8	1.7	1.6	1.6	1.6	1.6	1.6	1.6
COVID fund 2/		2.5	2.3	1.6	0.0						
Wage subsidies		0.9	0.6	0.1							
Social transfers		1.1	1.0	0.4							
Other spending		0.4	0.7	1.1							
Net acquisition of nonfinancial assets (incl. COVID spending) 3/	3.5	3.8	4.3	4.1	5.1	4.5	4.3	4.2	4.2	4.2	4.2
Gross operating balance	0.1	0.1	0.2	0.2	0.2	0.3	0.1	0.1	0.0	0.0	0.0
Net lending/borrowing	-3.4	-6.2	-6.4	-5.6	-5.0	-4.2	-4.2	-4.2	-4.2	-4.2	-4.2
II. Stock Positions					(In billions of ringgit)						
Federal government debt	793.0	879.6	979.8	1,079.6	1,174.7	1,261.8	1,355.5	1,453.7	1,559.3	1,670.6	1,787.8
(In percent of GDP)	52.4	62.0	63.3	60.3	61.5	61.2	61.2	61.5	62.5	63.3	64.1
Memorandum items:											
Structural balance (in billions of ringgit)	-80.2	-32.3	-55.7	-77.0	-85.4	-89.4	-96.5	-101.3	-107.5	-112.1	-117.8
Structural balance (percent of potential GDP)	-5.3	-2.2	-3.5	-4.4	-4.5	-4.4	-4.4	-4.3	-4.3	-4.2	-4.2
Structural primary balance (percent of potential GDP)	-3.1	0.1	-1.1	-2.0	-2.1	-1.9	-1.7	-1.5	-1.5	-1.3	-1.5
Primary balance (percent of GDP)	-1.2	-1.3	-1.6	-1.6	-2.6	-1.8	-1.5	-1.4	-1.4	-1.3	-1.5
Nonoil and gas primary balance (percent of GDP)	-6.7	-5.0	-4.4	-6.2	-6.2	-4.8	-4.2	-3.6	-3.5	-3.3	-3.1
Oil and gas revenues (percent of GDP)	5.5	3.8	2.8	4.6	3.7	3.0	2.7	2.3	2.1	2.0	1.6
General government debt (percent of GDP) 4/	57.1	12.8	69.2	65.6	66.8	66.6	66.5	66.8	67.8	68.7	69.4
General government balance (percent of GDP) 4/	-2.0	-4.9	-6.0	-4.8	-4.3	-3.5	-3.5	-3.4	-3.5	-3.5	-3.5
Public sector balance (percent of GDP)	-3.4	-7.3	-8.3	-6.7	-7.9	-5.9	-5.8	-5.6	-5.7	-5.7	-5.7
Nominal GDP (in billions of ringgit)	1,513	1,418	1,549	1,791	1,910	2,061	2,215	2,365	2,496	2,638	2,788

Sources: Data provided by the Malaysian authorities; and IMF staff estimates.

1/ Cash basis.

2/ The authorities established a dedicated COVID-19 trust fund where they channeled proceeds from borrowing needed to finance the additional spending on COVID-19 relief measures. All such expenditures are appropriated through the fund.

3/ Net acquisition of nonfinancial assets include lending and loan repayment to and from other government related entities. In 2020-2022, it includes COVID-related capital projects.

4/ General government includes federal government, state and local governments, and statutory bodies. Public sector includes general government and nonfinancial public enterprises.

Table 6. Malaysia: Depository Corporations, 2019–23 1/

	2019	2020	2021	Proj 2022	Proj 2023
	(In billions of ringgit; end of period)				
Net foreign assets	287.3	312.1	353.9	353.6	334.0
Foreign assets	582.8	601.0	659.8	677.7	703.8
Foreign liabilities	295.5	289.0	305.9	324.1	369.8
Net domestic assets	1,580.8	1,646.5	1,712.7	1,795.1	1,955.5
Net domestic credit	2,119.0	2,249.3	2,349.9	2,349.9	2,349.9
Net credit to nonfinancial public sector	197.5	250.5	278.3	278.3	278.3
Net credit to central government	173.4	226.8	254.4	299.0	341.9
Net credit to state & local government	1.9	1.4	1.7	1.9	2.1
Net credit to nonfinancial corporations	22.2	22.2	22.3	22.3	22.3
Credit to private sector 2/	1,826.0	1,898.2	1,970.9	2,029.7	2,163.6
Net credit to other financial corporations	95.4	100.6	100.9	116.7	124.4
Capital accounts	473.2	515.6	540.5	367.8	387.8
Other items (net)	-67.2	-87.5	-97.8	-102.3	-95.1
Broad money 3/	1,854.2	1,944.7	2,052.8	2,134.8	2,275.7
Narrow money	479.9	556.1	626.0	651.0	694.0
Currency in circulation	100.6	118.4	136.7	146.6	144.4
Transferable deposits	379.3	437.7	489.3	504.4	549.6
Other deposits	1,338.2	1,356.0	1,398.5	1,544.1	1,646.0
Securities other than shares	36.1	32.6	28.3	36.0	-64.3
	(Contributions to 12-month growth in broad money, in percentage points)				
Net foreign assets	-1.0	1.3	2.2	0.0	-0.9
Net domestic assets	3.4	3.5	3.4	4.0	7.5
Memorandum items:					
Broad money (12-month percent change)	2.4	4.9	5.6	4.0	6.6
Currency in circulation (12-month percent change)	6.5	17.7	15.5	7.2	-1.5
Credit to private sector (12-month percent change)	4.9	4.0	3.8	3.0	6.6
Money multiplier (broad money/narrow money)	3.9	3.5	3.3	3.3	3.3

Sources: Data provided by the Malaysian authorities; and IMF, *Integrated Monetary Database* and staff calculations.
1/ Based on data provided by the authorities, but follows compilation methodology used in IMF's Integrated Monetary Database.
2/ Actual data as provided by the Malaysian monetary authorities in the Integrated Monetary Database.
3/ Broad money does not equal the sum of net foreign assets and net domestic assets due to non-liquid liabilities, primarily at the other depository corporations.

Table 7. Malaysia: Banks' Financial Soundness Indicators, 2018–2023Q3

	2018	2019	2020	2021	2022	2023Q3
	(In percent; end of period)					
Capital adequacy						
Regulatory capital to risk-weighted assets	18.1	18.6	18.9	19.2	19.0	18.2
Regulatory Tier 1 capital to risk-weighted assets	14.6	15.1	15.7	16.0	15.8	15.0
Asset quality						
Nonperforming loans net of provisions to capital 1/	5.1	5.5	5.5	6.1	6.3	6.4
Nonperforming loans to total gross loans	1.5	1.5	1.6	1.7	1.7	1.7
Earnings and profitability						
Return on assets	1.4	1.5	1.1	1.2	1.5	1.4
Return on equity	9.9	10.2	7.5	8.4	10.0	9.9
Interest margin to gross income	61.0	57.8	58.1	61.4	61.1	57.5
Non-interest expenses to gross income	42.0	42.3	42.5	44.5	41.1	44.8
Liquidity						
Liquid assets to total assets (liquid asset ratio)	0.0	0.0	0.0	0.0	0.0	0.0
Liquid assets to short-term liabilities	0.0	0.0	0.0	0.0	0.0	0.0
Loan to fund ratio	83.1	83.2	82.5	81.2	82.5	82.5
Liquidity coverage ratio	143.2	149.1	148.2	153.3	151.5	151.5
Sensitivity to market risk						
Net open position in foreign exchange to capital	5.5	4.2	5.3	4.2	3.5	4.2

Sources: Bank Negara Malaysia; and IMF, *Financial Soundness Indicators* database.

1/ Loans are classified as nonperforming if payments are overdue for three months or more. Total loans include housing loans sold to Cagamas Berhad. Net nonperforming loans exclude interest-in-suspense and specific provisions. There is a methodology change since 2018 following the implementation of Malaysian Financial Reporting Standards (MFRS) 9.

Appendix I. Malaysia's National Strategic Plans[1]

1. **The MADANI Economy Framework serves as the primary economic foundation for Malaysia's national strategic plans.** The framework aims to address Malaysia's immediate to long-term challenges, reform the economy to a higher value chain and raise the standards of living. It sets out seven medium-term targets for the next decade to bolster economic growth and competitiveness, quality of life, labor inclusiveness, fiscal sustainability, and stem corruption. Several policies, focusing on different aspects of the economy and anchored by the MADANI Economy Framework, have since been launched.

2. **Several national strategies aim to support the MADANI framework.** The National Energy Transition Roadmap (NETR) reinforces Malaysia's commitment towards net-zero as early as 2050 via six energy transition levers, energy efficiency, renewable energy, hydrogen, bioenergy, green mobility and carbon capture, utilization and storage (CCUS). The plan seeks to increase the use of renewable energy and close to completely phase out coal in Malaysia's power generation mix by 2050. The New Industrial Master Plan 2030 (NIMP) provides a strategic direction towards a high-tech industrial nation till 2030. The plan aims to attract high quality investments, create high value job opportunities, and significantly raise median income. The Mid-Term Review of the 12th Malaysia Plan (12MP) for 2023-25 encompasses revised strategies to align with the MADANI Economy Framework. The plan focuses on enhancing the efficiency of public service delivery, which will enable strengthening sustainability, building a prosperous society and achieving high-income status via 17 big bold measures.

Figure 1. Malaysia: National Strategic Plans Anchored by MADANI Economy Framework

Madani Economy Framework				
7 Medium-Term Targets	Top 30 largest economy	Top 12 in global competitiveness	Top 25 on Human Development index	Increase labor share of income to 45%
	Top 25 in Corruption Perception Index	Fiscal sustainability, targeting deficit of 3% or better	Increase in Female Labour Force Participation Rate to 60%	

National Energy Transition Roadmap (NETR)	The New Industrial Master Plan 2030 (NIMP 2030)	Mid-Term Review of the 12th Malaysia Plan (12MP)			
6 Energy Transition Levers	*6 Key Goals*	*1 Key Enabler, 3 Key Themes and 17 Big Bold Measures*			
Energy Efficiency (EE)	Increase economic complexity	Enhancing efficiency of public service delivery	Strengthening sustainability	Building prosperous society	Achieving high-income nation
Renewable Energy (RE)	Create high-value job opportunities	Governance and Institutional Framework	Fiscal sustainability & financial systems	Enculturation of Madani Society	Digital- and technology-based HGHV industries
Hydrogen	Extend domestic linkages	Legislation related to corruption	High Growth High Value (HGHV) Industry based on energy transition	Social protection reforms	High value Electrical and electronic (E&E) and HGHV industry
Bioenergy	Develop new and existing clusters		Targeted subsidies	Housing for the Rakyat	Agriculture and agro-based HGHV industry
Green Mobility	Improve Inclusivity			Strengthening healthcare services	Rare earths HGHV industry
Carbon Capture, Utilisation and Storage (CCUS)	Enhance ESG practices			Strengthening national security and defense	Empowering micro, small and medium entreprises (MSMEs) and social
					Streamlining the public transport network
					Future-ready talent

[1] Prepared by Defa Zhao.

Appendix II. Sovereign Risk and Debt Sustainability Analysis[1]

Malaysia is at a moderate overall risk of sovereign stress. Under current policies, debt is projected to gradually rise over the medium and long term. Medium-term liquidity risks as analyzed by the GFN Finance ability Module are moderate. Long-term risks related to pension demographics, large amortization requirements, and climate mitigation appear moderate. Large contingent liabilities increase fiscal risks. Malaysia should accelerate revenue mobilization to put debt on a firm downward path and reduce risks.

Figure 1. Malaysia: Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	…	Moderate	The overall risk of sovereign stress is moderate, reflecting moderate levels of vulnerability in the medium-, and long-term horizons.
Near term 1/			
Medium term	Moderate	Moderate	Medium-term risks are assessed as moderate on the basis of authorities' medium-term consolidation plans, though specific measures have not been identified.
Fanchart	Moderate	…	
GFN	Moderate	…	
Stress test	Cont. Liabty.	…	
Long term	…	Moderate	Long-term risks related to pension demographics, large amortization needs, and climate adapation and mitigation appear moderate.
Sustainability assessment 2/	Not required for surveillance countries	Sustainable with high probability	
Debt stabilization in the baseline			No

DSA Summary Assessment

Commentary: Malaysia is at a moderate overall risk of sovereign stress. Under current policies, debt is projected to gradually rise over the medium and long term, driven in part by Malaysia's long-standing revenue weakness. Medium-term liquidity risks as analyzed by the GFN Finance ability Module are moderate. Large contingent liabilities increase fiscal risks. Malaysia should accelerate important fiscal reforms such as developing a medium-term revenue strategy to put debt on a firm downward path and reduce risks.

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

[1] Prepared by Ghada Fayad.

Figure 2. Malaysia: Debt Coverage and Disclosures

1. Debt coverage in the DSA: 1/

CG	GG	NFPS	CPS	Other	Comments
CG (chosen)	GG	NFPS	CPS	Other	

1a. If central government, are non-central government entities insignificant? 0

2. Subsectors included in the chosen coverage in (1) above:

Sector		Subsectors captured in the baseline	Inclusion	Comments
CPS / NFPS / GG: expected / CG	1	Budgetary central government	Yes	
CPS / NFPS / GG: expected / CG	2	Extra budgetary funds (EBFs)	No	Not applicable
CPS / NFPS / GG: expected / CG	3	Social security funds (SSFs)	Yes	
CPS / NFPS / GG: expected	4	State governments	No	
CPS / NFPS / GG: expected	5	Local governments	No	
CPS / NFPS	6	Public nonfinancial corporations	No	
CPS	7	Central bank	No	
CPS	8	Other public financial corporations	No	

3. Instrument coverage:

Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/
chosen	chosen	chosen	missing	missing

4. Accounting principles:

Basis of recording		Valuation of debt stock		
Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/
	chosen	chosen		

5. Debt consolidation across sectors:

Consolidated	Non-consolidated
	chosen

Color code: chosen coverage | Missing from recommended coverage | Not applicable

Reporting on Intra-government Debt Holdings

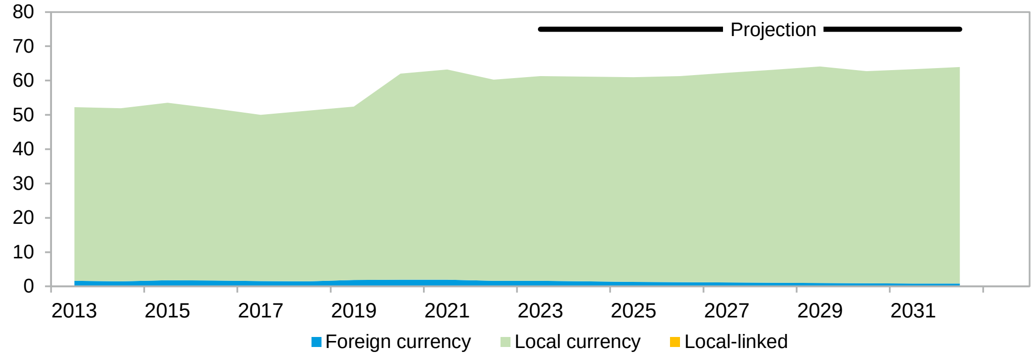
Issuer \ Holder			Budget. central govt	Extra-budget. funds (EBFs)	Social security funds (SSFs)	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
CPS / NFPS / GG: expected / CG	1	Budget. central govt									0
CPS / NFPS / GG: expected / CG	2	Extra-budget. funds									0
CPS / NFPS / GG: expected / CG	3	Social security funds									0
CPS / NFPS / GG: expected	4	State govt.									0
CPS / NFPS / GG: expected	5	Local govt.									0
CPS / NFPS	6	Nonfin pub. corp.									0
CPS	7	Central bank									0
CPS	8	Oth. pub. fin. corp									0
		Total	0	0	0	0	0	0	0	0	0

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary: Debt coverage is federal or central government, consistent with the data on government debt reported by the authorities. This definition of debt covers more than 90 percent of general government debt. However, it does not include local and state governments and statutory bodies which typically receive explicit government guarantees. Malaysia's contingent liabilities include government loan guarantees (GG) granted to non-financial government-related entities to execute mainly infrastructure and other strategic projects.

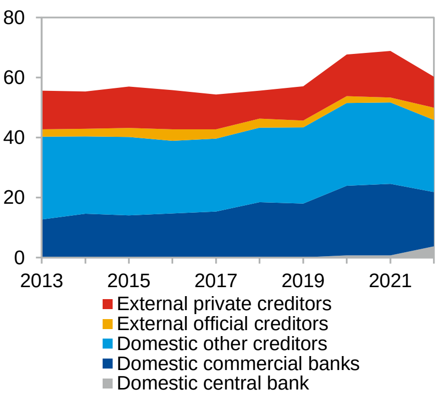
Figure 3. Malaysia: Public Debt Structure Indicators

Debt by Currency (percent of GDP)



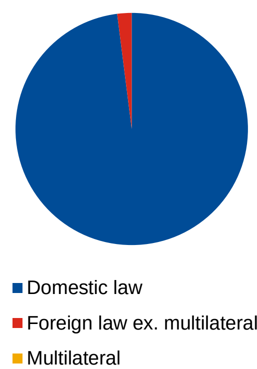
Note: The perimeter shown is central government.

Public Debt by Holder (percent of GDP)



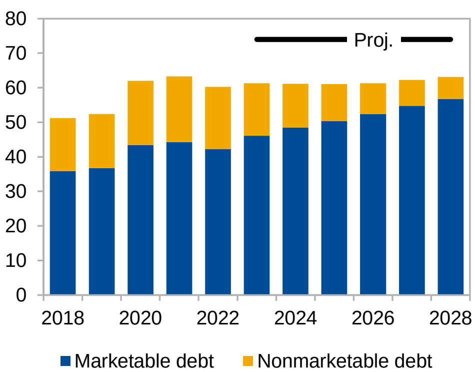
Note: The perimeter shown is central government.

Public Debt by Governing Law, 2022 (percent)



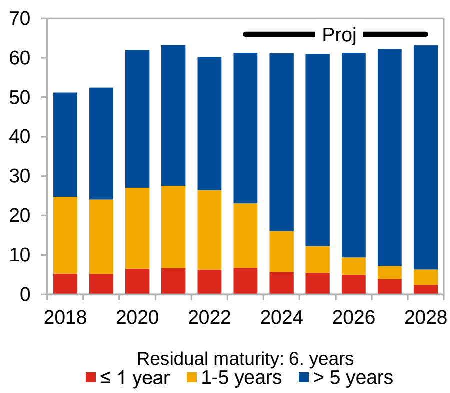
Note: The perimeter shown is central government.

Debt by Instruments (percent of GDP)



Note: The perimeter shown is central government.

Public Debt by Maturity (percent of GDP)



Note: The perimeter shown is central government.

Commentary: Domestic creditors held about 76 percent of public debt. About 90 percent of external debt (and 97 percent of overall debt) is issued in local currency. The main domestic creditors are the Employees Provident Fund and commercial banks. All public debt, with the exception of Sukuk bonds, is governed by domestic law. A large proportion of debt is issued at longer maturities, as part of the government's debt management objective to reduce rollover risks by lengthening the issuance tenure to establish a well-spread maturity profile.

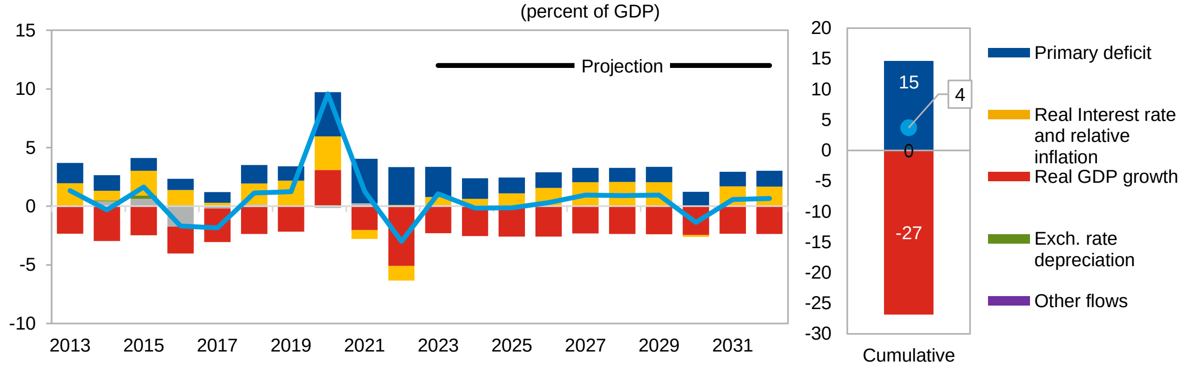
Figure 4. Malaysia: Baseline Scenario

(percent of GDP unless indicated otherwise)

	Actual	Medium-term projection						Extended projection			
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Public debt	60.3	61.3	61.2	61.0	61.3	62.3	63.2	64.1	62.7	63.3	63.9
Change in public debt	-3.0	1.0	-0.2	-0.1	0.3	0.9	0.9	1.0	-1.4	0.6	0.7
Contribution of identified flows	-2.9	0.9	-0.1	-0.1	0.3	0.9	0.9	1.0	-1.4	0.6	0.7
Primary deficit	3.2	2.6	1.8	1.4	1.3	1.2	1.2	1.3	1.2	1.2	1.4
Noninterest revenues	16.4	15.9	14.9	14.7	14.1	14.1	14.0	13.8	13.3	13.3	13.2
Noninterest expenditures	19.7	18.5	16.7	16.0	15.5	15.3	15.2	15.1	14.5	14.5	14.6
Automatic debt dynamics	-6.2	-1.6	-1.9	-1.5	-1.0	-0.3	-0.3	-0.3	-2.6	-0.7	-0.7
Real interest rate and relative inflation	-1.2	0.7	0.6	1.1	1.6	2.0	2.1	2.0	-0.2	1.7	1.7
Real interest rate	-1.2	0.7	0.6	1.1	1.6	2.1	2.1	2.0	-0.2	1.7	1.7
Relative inflation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real growth rate	-5.0	-2.3	-2.5	-2.6	-2.6	-2.3	-2.4 .	-2.4	-2.4	-2.4	-2.4
Real exchange rate	0.1	…	…	…	…	…	… .	…	…	…	…
Other identified flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(minus) Interest Revenues	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other transactions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contribution of residual	-0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross financing needs	11.6	10.7	10.6	8.8	8.4	7.6	6.3	5.2	5.2	6.0	5.5
of which: debt service	8.3	8.1	8.8	7.4	7.1	6.4	5.1	3.9	4.0	4.7	4.1
Local currency	8.1	8.1	8.7	7.3	7.0	6.4	5.0	3.9	4.0	4.7	4.1
Foreign currency	0.2	0.0	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Memo:											
Real GDP growth (percent)	8.7	4.0	4.3	4.4	4.4	3.9	3.9	3.9	3.9	3.9	3.9
Inflation (GDP deflator; percent)	6.4	2.5	3.5	2.9	2.2	1.6	1.7	1.7	5.4	2.3	2.3
Nominal GDP growth (percent)	15.7	6.6	7.9	7.5	6.7	5.6	5.7	5.7	9.5	6.3	6.3
Effective interest rate (percent)	4.2	3.8	4.6	4.8	5.0	5.1	5.2	5.1	5.1	5.1	5.1

Contribution to Change in Public Debt

(percent of GDP)



Commentary: Public debt will gradually rise over the forecast horizon, reflecting reflecting a primary deficit that remains about 2 ppts of GDP above its debt stabilizing level in 2032.

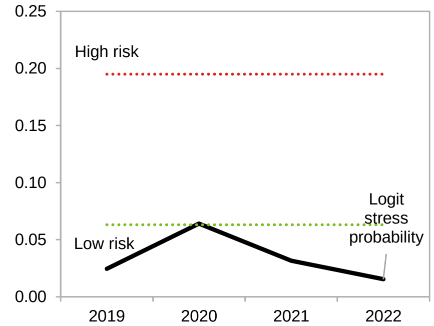
Figure 5. Malaysia: Near-Term Risk Analysis

Year of data	2019	2020	2021	2022
To predict stress in [t+1, t+2]	*2020-21*	*2021-22*	*2022-23*	*2023-24*
Logit stress probability (LSP)	0.024	0.064	0.032	0.015
Change in LSP	-0.004	0.040	-0.032	-0.016
due to:				
Institutional quality	0.001	-0.003	0.000	0.000
Stress history	0.000	0.000	0.000	0.000
Cyclical position	0.004	-0.006	0.033	-0.016
Debt burden & buffers	-0.001	0.019	-0.016	-0.005
Global conditions	-0.008	0.028	-0.049	0.005

Prob. of missed crisis, 2023-2024 (if stress not predicted): 0.0 pct.

Prob. of false alarm, 2023-2024 (if stress predicted): 68.0 pct.

Evolution of Mechanical Near-term Signal

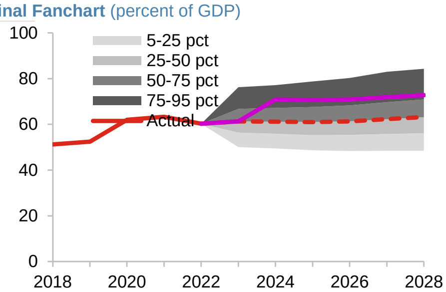


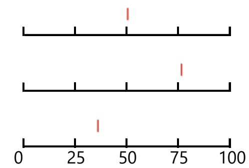
Commentary: Malaysia's risk of near-term stress is low. This is driven by the strong recovery in 2022 and the resulting decline in debt in percent of GDP.

Figure 6. Malaysia: Medium-Term Risk Assessment

	Value	Contrib [1/]	Percentile in peer group [2/]
Debt fanchart module			
Fanchart width *(percent of GDP)*	35.9	0.5	
Probability of debt non-stabilizaiton *(percent)*	77.6	0.7	
Terminal debt-to-GDP x institutions index	23.3	0.5	
Debt fanchart index (DFI)		1.7	
Risk signal: [3/]		**Moderate**	

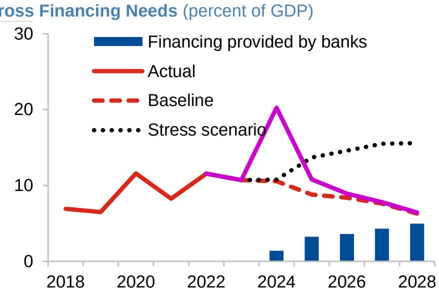
Final Fanchart (percent of GDP)

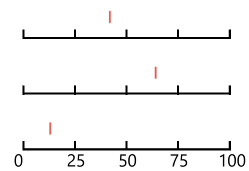




	Value	Contrib [1/]	Percentile in peer group [2/]
Gross financing needs (GFN) module			
Average baseline GFN *(percent of GDP)*	8.7	3.0	
Initial Banks' claims on the gen. govt *(pct bank assets)*	12.2	4.0	
Chg. In banks' claims in stress *(pct banks' assets)*	3.1	1.0	
GFN financeability index (GFI)		8.0	
Risk signal: [4/]		**Moderate**	

Gross Financing Needs (percent of GDP)

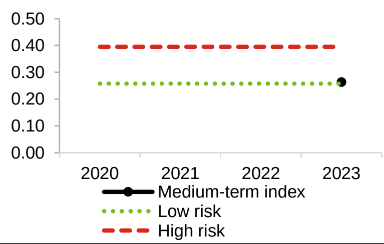




Triggered stress tests (stress tests not activated in gray)

Banking crisis | Commodity prices | Exchange rate | Contingent liab. | Natural disaster

Medium-term Index (index number)



Medium-term risk analysis

	Value	Value (normalize	Weight	Contribution
Debt fanchart index	1.7	0.4	0.5	0.2
GFN finaceability index	8.0	0.2	0.5	0.1
Medium-term index		0.3		
Risk signal: 5/		**Moderate**		
Final assessment:		**Moderate**		

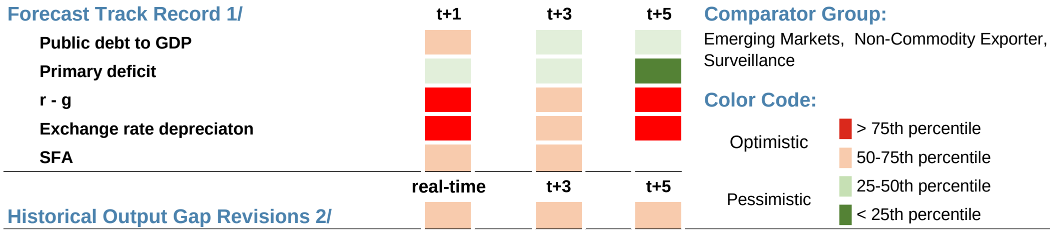
Prob. of missed crisis, 2023-2028, if stress not predicted: 18.2 pct.
Prob. of false alarms, 2023-2028, if stress predicted: 39.8 pct.

Commentary: The two medium-term tools, the Debt Fanchart Module and the GFN Financeability Module, suggest moderate levels of risk.

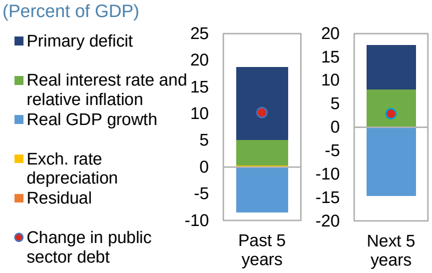
Source: IMF staff estimates and projections.

1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.
2/ The comparison group is emerging markets, non-commodity exporter, surveillance.
3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.
4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.
5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

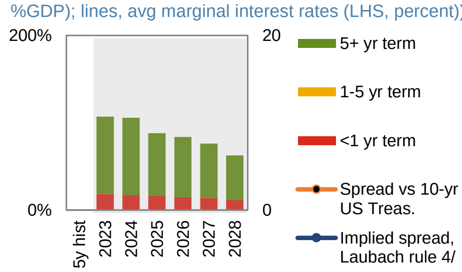
Figure 7. Malaysia: Realism of Baseline Assumptions



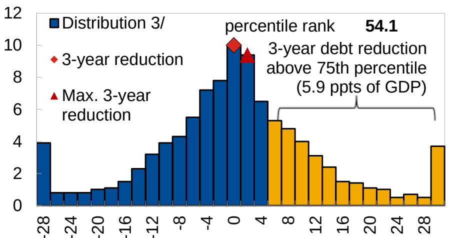
Public Debt Creating Flows
(Percent of GDP)



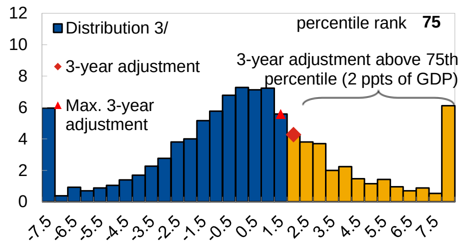
Bond Issuances (bars, debt issuances (RHS, %GDP); lines, avg marginal interest rates (LHS, percent))



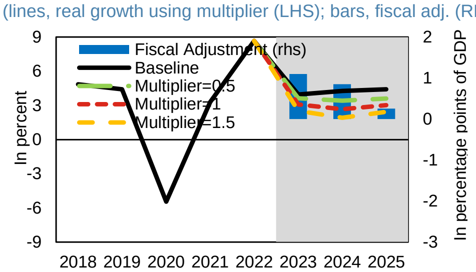
3-Year Debt Reduction
(Percent of GDP)



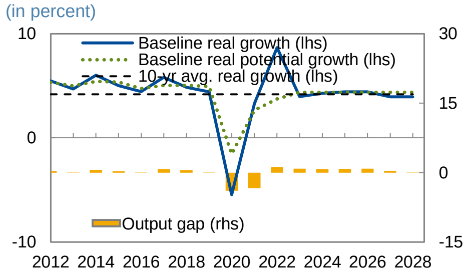
3-Year Adjustment in Cyclically-Adjusted Primary Balance (percent of GDP)



Fiscal Adjustment and Possible Growth Paths
(lines, real growth using multiplier (LHS); bars, fiscal adj. (RHS))



Real GDP Growth
(in percent)



Commentary: Realism analysis does not point to major biases: median forecast errors for the medium-term primary deficit and public debt projections are neither optimistic nor pessimistic. The baseline does not incoporate any medium-term fiscal consolidation effort, beyond the budget year.

Source : IMF Staff.

1/ Projections made in the October and April WEO vintage.

2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates

3/ Data cover annual obervations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

Figure 8. Malaysia: Long-term Risk Assessment

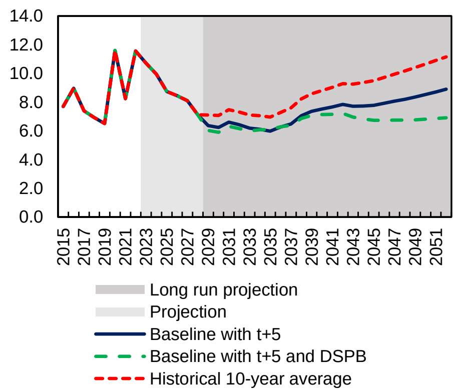
Malaysia: Triggered Modules

Large amortizations	**Pensions**	Climate change: Adaptation	Natural Resources
	Health	**Climate change: Mitigation**	

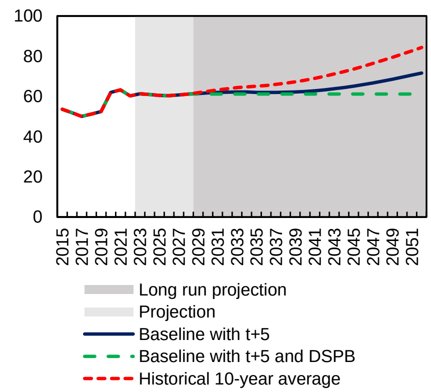
Malaysia: Long-term Risk Assessment: Large Amortization

Projection	Variable	Risk Indication
Medium-term extrapolation	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	
Medium-term extrapolation with debt stabilizing primary balance	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	
Historical average assumptions	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	
Overall Risk Indication		

GFN-to-GDP Ratio



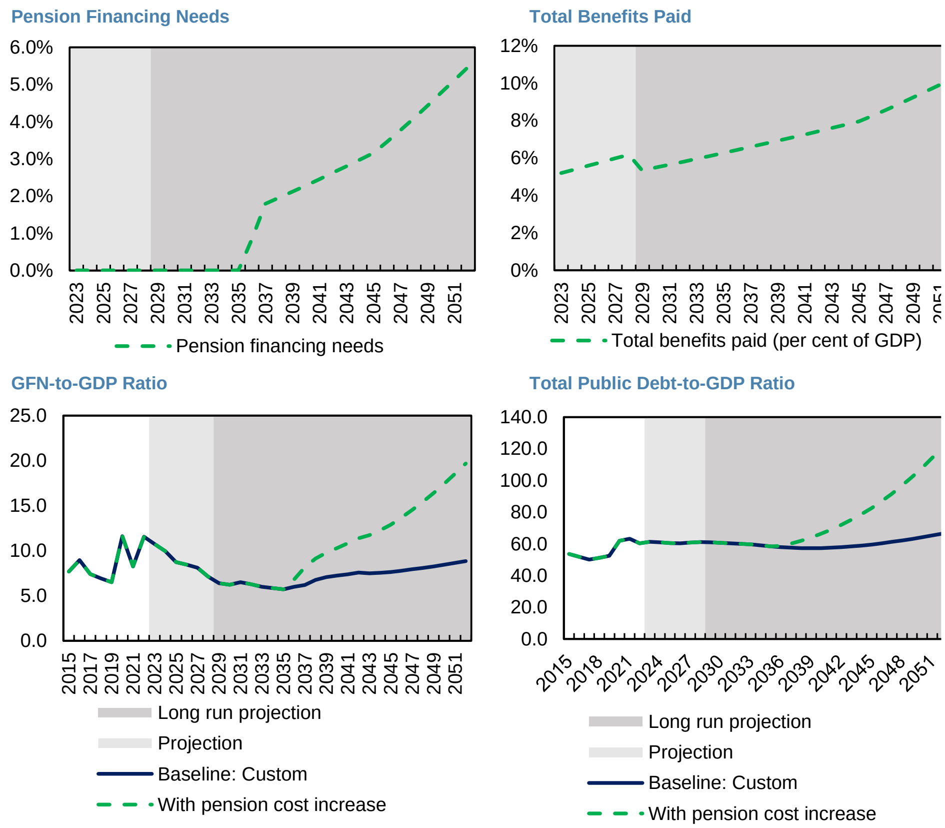
Total Public Debt-to-GDP Ratio



Commentary: Large amortization needs are driven by Malaysia's long debt maturity implying an increase in GFN outside the perimeter of the projected period

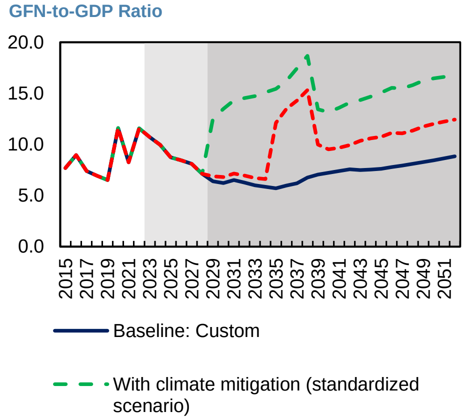
Figure 9. Malaysia: Demographics: Pensions

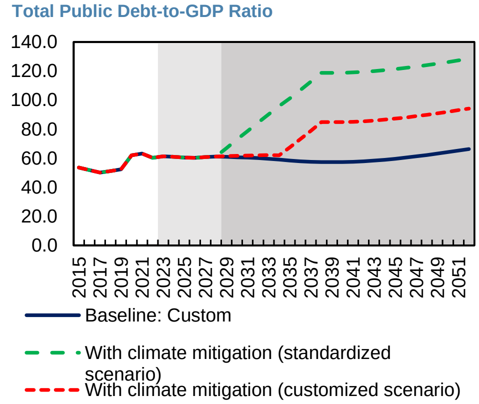
Permanent adjustment needed in the pension system to keep pension assets positive for:	30 years	50 years	Until 2100
(pp of GDP per year)	2.0%	4.9%	7.4%



Given Malaysia's aging population, financing needs from pension underfinancing are expected to rise in the long term, starting from 2035 when pension assets are depleted, with debt increasing to cover pension financing needs.

Figure 10. Malaysia: Climate Change: Mitigation





Climate mitigation costs are expected to incerase gross financing needs and debt using a customized scenario of such costs being only partly accounted for in the medium-term framework.

Appendix III. External Debt Sustainability Analysis[1]

Malaysia's external debt increased moderately in 2023, as nonresidents' holdings of domestic debt and residents' offshore borrowings increased. External debt remains manageable, with one-third of debt denominated in local currency, and about 42 percent of short-term external debt in the form of intragroup borrowings among banks and corporations, which are generally stable.

1. **Malaysia's external debt, as a share of GDP, is expected to increase in 2023 compared to 2022.** Malaysia's external debt-to-GDP ratio is expected to increase to 67 percent of GDP at end-2023, moderately higher than the 64 percent of GDP at end-2022. This increase in external debt compared to 2022 is largely due to a weakening ringgit against the US dollar and other major currencies and higher borrowing by corporates mainly in the form of intercompany loans. Total external debt in absolute terms increased in 2023, as offshore medium- and long-term borrowings, namely private sector external debt, rose. Higher nonresident holdings of domestic debt securities and higher short-term deposits of foreign entities also contributed to the increase in external debt. Public sector borrowing remained broadly unchanged compared to 2022.

2. **The currency profile of external debt is stable.** As of end-September 2023, one-third of external debt (32.7 percent of total external debt) was denominated in ringgit, largely in the form of nonresident holdings of domestic debt securities (65.8 percent of ringgit-denominated external debt) and in ringgit deposits in domestic banking institutions. As such, these liabilities are not subject to valuation changes arising from exchange rate fluctuations. The remaining two-thirds of external debt (67.3 percent of total external debt) is denominated in foreign currency (FC). The non-financial corporate sector accounted for over half of FC-denominated external debt, which is largely subject to prudential and hedging requirements. A significant share of FC-denominated external debt is accounted by interbank borrowings and FC deposits in the domestic banking system, which are subject to prudential standards. Another one-third of FC-denominated external debt comprises bonds and notes issued offshore and loans, which are subject to hedging requirements.

3. **From a maturity perspective, the share of short-term external debt by original maturity increased marginally in 2023.** Short-term debt by original maturity is projected to account for 43.4 percent of total external debt by end-2023. Over 40 percent of the short-term external debt are in the form of intragroup borrowings among parent banks and multi-national corporates which are generally stable. Meanwhile, less than one-fifth are accounted by trade credits, which are largely backed by export earnings and are self-liquidating.

4. **Over the medium term, external debt-to-GDP ratio is projected to return to a steady downward path.** Total external debt is projected to fall to about 64 percent by 2028. This baseline path is slightly higher than the previously projected path as it reflects the higher external financing rates and also captures the valuation effect from a significant depreciation of the ringgit against the US dollar in 2023. The downward path reflects the net effect of sustained current account (CA) surpluses (excluding interest payments), a recovery in economic growth supported by domestic

[1] Prepared by Shujaat Khan.

demand, and capital inflows over the medium-term. The share of short-term debt, by original maturity, is projected to stabilize at about 51 percent of total external debt by 2028. Gross external financing needs are estimated to remain stable around 32 percent of GDP (Table 2).

5. **Sizable external debt would keep Malaysia's external vulnerabilities elevated, albeit manageable.** Standard stress tests under the external DSA indicate that external debt is most vulnerable to an exchange rate depreciation. A 30 percent real exchange rate depreciation in 2023 could push external debt to about 86 percent of GDP by 2028. Moreover, the materialization of a persistent historical shock could lead to an external debt level around 85 percent of GDP in the outer years. Other scenarios—such as a deceleration in real GDP growth and a rise in the interest rate, would lead to moderate increases in external debt. The impact of these shocks would be mitigated by: (i) the high share of ringgit-denominated external debt and (ii) largely stable intercompany loans and interbank borrowings.

6. **While risks to Malaysia's external debt sustainability arising from the above vulnerabilities have increased, they can be managed via a variety of mitigation measures.** As of end-2023, gross official reserves stood at US$113.5 billion, or about 75 percent of short-term external debt. The coverage of gross official reserves while adequate under the IMF reserve adequacy metric (ARA) (110 percent of the metric at end-2023), dropped during most of the year. Exchange rate flexibility, a moderate CA surplus, and the relatively large share of ringgit-denominated external debt will continue to serve as important buffers against potential external shocks. Moreover, banks' exposure in the form of interbank borrowings, NR deposits and debt issuances are subject to prudential requirements on liquidity and funding risk management, while corporations are subject to an approval framework to ascertain that external borrowings are utilized for productive purposes and that they are supported by foreign currency earnings.

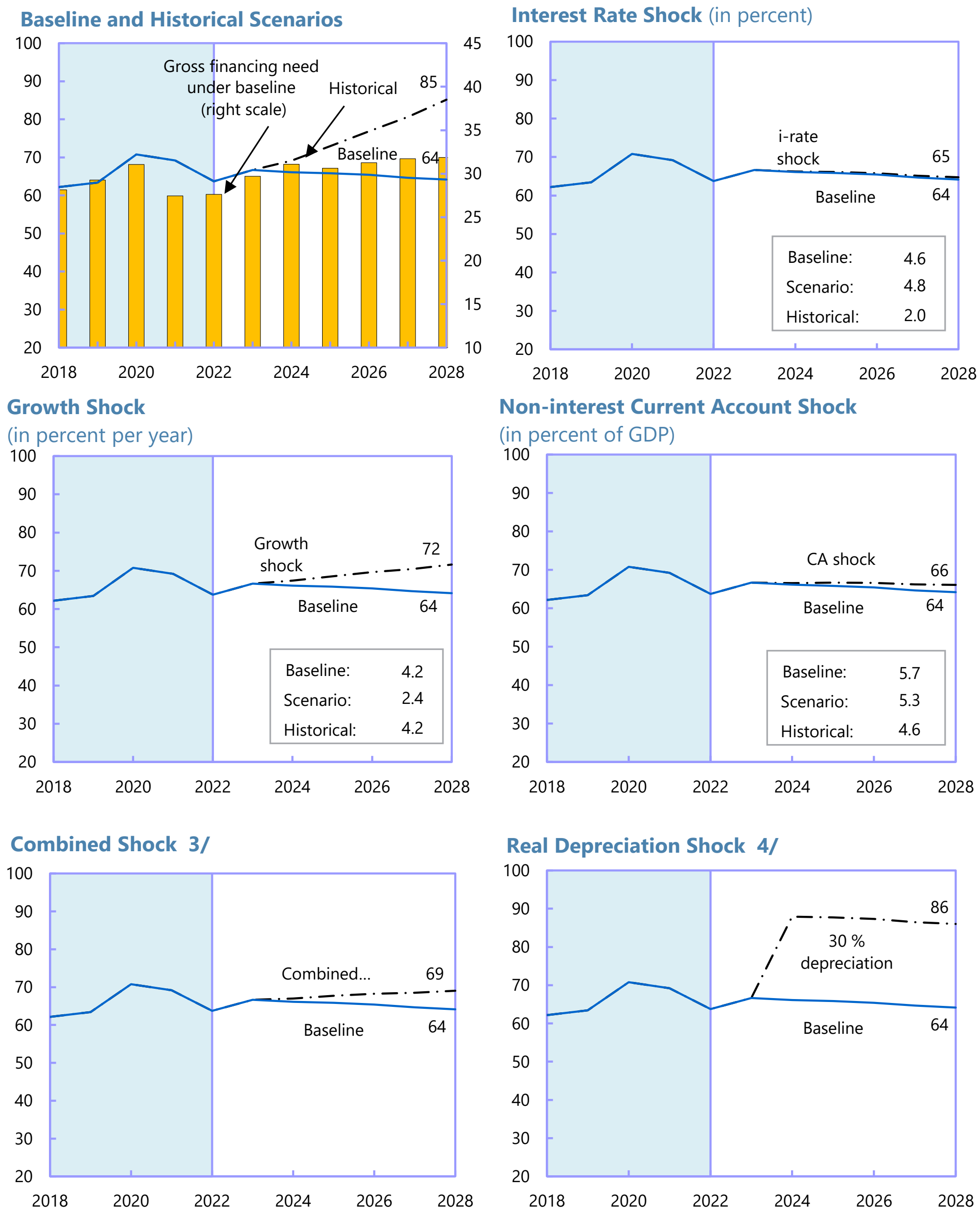
Table 1. Malaysia: Profile of External Debt

(In percent of GDP, unless otherwise mentioned; original maturity)

	2018	2019	2020	2021	2022	2023Q1	2023Q2	2023Q3
Total external debt	63.8	62.6	67.6	69.7	63.9	64.5	67.1	69.0
Medium- and long-term	*35.8*	*36.9*	*41.7*	*43.7*	*37.0*	*36.8*	*39.1*	*39.8*
Offshore borrowing	22.9	23.0	25.5	25.3	21.4	20.6	22.2	22.8
Public sector	9.5	8.5	10.1	10.5	8.1	7.3	8.0	8.1
Federal government	1.2	1.6	1.7	1.6	1.4	1.4	1.4	1.4
Public enterprises	8.4	6.9	8.4	8.9	6.7	5.9	6.6	6.7
Private sector	13.4	14.5	15.4	14.7	13.2	13.3	14.2	14.7
Banks	3.3	3.7	3.9	3.5	3.0	2.9	3.1	3.1
Nonbanks	10.1	10.8	11.5	11.2	10.2	10.4	11.1	11.6
Nonresident holdings of ringgit-denominated debt instruments	11.7	12.8	14.9	15.9	13.3	13.8	14.3	14.5
Government securities	10.9	12.0	14.1	15.0	12.6	13.3	13.7	13.9
Other securities	0.7	0.7	0.8	0.9	0.7	0.6	0.6	0.6
Other	1.2	1.1	1.3	2.5	2.3	2.4	2.6	2.5
Short-term	*28.0*	*25.8*	*25.9*	*26.1*	*26.9*	*27.7*	*28.0*	*29.2*
Offshore borrowing	16.2	14.2	14.0	13.0	13.6	14.2	13.5	14.8
Public sector	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private sector	16.2	14.2	14.0	13.0	13.6	14.2	13.5	14.8
Banks	14.1	13.2	12.8	11.4	12.2	12.8	12.0	13.1
Nonbanks	2.0	1.0	1.2	1.6	1.4	1.4	1.6	1.7
Nonresident holdings of ringgit-denominated debt instruments	0.8	0.5	0.7	0.6	0.5	0.4	0.5	0.3
Government securities	0.3	0.1	0.4	0.5	0.4	0.3	0.4	0.2
Other securities	0.5	0.4	0.2	0.1	0.1	0.1	0.1	0.1
Nonresident deposits	6.8	6.8	6.7	6.4	6.2	7.1	7.4	7.7
Other	4.3	4.2	4.6	6.1	6.6	6.1	6.6	6.4
	(In percent of total external debt unless otherwise mentioned)							
By original maturity:								
Short-term	43.9	41.1	38.3	37.4	42.1	42.9	41.8	42.3
Medium- and long-term	56.1	58.9	61.7	62.6	57.9	57.1	58.2	57.7
By currency:								
Local currency denominated	30.3	32.8	33.9	34.5	33.1	34.0	33.4	32.7
Foreign currency denominated	69.7	67.2	66.1	65.5	66.9	66.0	66.6	67.3
By instrument:								
Nonresident holdings of ringgit-denominated debt instruments	19.5	21.2	23.0	23.6	21.5	22.1	22.1	21.5
Interbank borrowing	22.1	21.1	19.0	16.4	19.1	19.8	17.8	19.0
as share of GDP	14.1	13.2	12.8	11.4	12.2	12.8	12.0	13.1
Bonds and notes	16.6	16.5	18.0	18.3	15.4	13.6	14.5	14.0
Intercompany loans	14.8	13.4	13.4	13.4	13.6	13.9	14.3	14.8
as share of GDP	9.4	8.4	9.0	9.3	8.7	9.0	9.6	10.2
Nonresident deposits	10.6	10.9	9.9	9.2	9.7	10.9	11.1	11.1
Loans	7.9	8.3	8.0	6.8	6.6	6.6	6.7	6.6
Others	8.5	8.4	8.7	12.4	14.0	13.1	13.6	12.9
Gross official foreign exchange reserves (US$ billion)	101.4	103.6	107.6	116.9	114.7	115.5	111.4	110.1

Sources: Bank Negara Malaysia; and IMF staff calculations.

Figure 1. Malaysia: External Debt Sustainability: Bound Tests 1/ 2/
(In percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2021.

Table 2. Malaysia: External Debt Sustainability Framework, 2018–2028

(In percent of GDP, unless otherwise indicated)

	Actual							Est.	Proj.					
	2018	2019	2020	2021	2022	10-Year Historical Average	10-Year Standard Deviation	2023	2024	2025	2026	2027	2028	Debt-stabilizing non-interest current account 6/
Baseline: External debt	62.2	63.4	70.8	69.2	63.7			**66.7**	**66.1**	**65.8**	**65.4**	**64.7**	**64.2**	**-3.0**
Change in external debt	-6.1	1.2	7.4	-1.6	-5.5			2.9	-0.5	-0.3	-0.4	-0.8	-0.5	
Identified external debt-creating flows (4+8+9)	-8.2	-5.0	0.4	-12.5	-9.7			-5.7	-6.4	-6.4	-6.5	-6.3	-6.2	
Current account deficit, excluding interest payments	-3.7	-5.1	-6.0	-5.1	-4.1			-4.5	-5.9	-6.1	-5.7	-5.4	-5.2	
Deficit in balance of goods and services	-6.7	-7.5	-6.4	-7.2	-7.2			-5.6	-5.8	-6.0	-6.2	-6.3	-6.2	
Exports	68.6	65.3	61.6	70.6	77.0			68.3	72.9	72.4	71.3	70.6	69.7	
Imports	61.8	57.8	55.2	63.4	69.7			62.7	67.1	66.4	65.1	64.3	63.5	
Net non-debt creating capital inflows (negative)	0.1	0.1	-0.2	-2.0	-0.9			-0.9	-1.0	-1.0	-1.0	-0.9	-0.9	
Automatic debt dynamics 1/	-4.6	0.0	6.7	-5.4	-4.7			-0.4	0.6	0.7	0.2	0.0	-0.1	
Contribution from nominal interest rate	1.5	1.6	1.9	1.2	1.0			2.1	3.2	3.4	2.9	2.4	2.3	
Contribution from real GDP growth	-2.9	-2.7	3.7	-2.1	-5.6			-2.4	-2.7	-2.7	-2.7	-2.4	-2.4	
Contribution from price and exchange rate changes 2/	-3.1	1.1	1.1	-4.5	-0.1			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	2.1	6.3	6.9	10.9	4.2			8.7	5.9	6.2	6.1	5.5	5.7	
External debt-to-exports ratio (in percent)	90.7	97.1	114.9	98.0	82.8			97.6	90.7	91.0	91.8	91.6	92.0	
Gross external financing need (in billions of US dollars) 4/	101.0	106.9	104.9	102.6	112.4			125.1	139.5	148.0	162.0	176.1	190.0	
in percent of GDP	28.1	29.3	31.1	27.5	27.6			29.7	31.1	30.6	31.3	31.7	31.9	
Scenario with key variables at their historical averages 5/								**66.7**	**69.1**	**73.0**	**76.9**	**80.6**	**85.2**	**-0.5**
Key Macroeconomic Assumptions Underlying Baseline														
Nominal GDP (US dollars)	358.8	365.2	337.5	373.8	407.0			421.3	448.6	483.1	518.2	555.1	596.2	
Real GDP growth (in percent)	4.8	4.4	-5.5	3.3	8.7	4.2	3.7	4.0	4.3	4.4	4.4	3.9	3.9	
GDP deflator in US dollars (change in percent)	7.2	-2.5	-2.2	7.2	-1.6	-1.5	6.5	-0.4	2.1	3.1	2.7	3.1	3.3	
Nominal external interest rate (in percent)	2.4	2.6	2.7	1.9	1.6	2.0	0.4	3.3	5.2	5.5	4.7	4.0	3.8	
Growth of exports (US dollar terms, in percent)	10.1	-3.1	-12.8	27.1	18.6	3.1	13.6	-8.2	13.7	6.9	5.7	6.0	6.2	
Growth of imports (US dollar terms, in percent)	10.1	-5.0	-11.7	27.2	19.7	3.6	13.4	-6.9	13.9	6.6	5.2	5.8	6.1	
Current account balance, excluding interest payments	3.7	5.1	6.0	5.1	4.1	4.6	0.8	4.5	5.9	6.1	5.7	5.4	5.2	
Net non-debt creating capital inflows	-0.1	-0.1	0.2	2.0	0.9	0.1	1.4	0.9	1.0	1.0	1.0	0.9	0.9	

Sources: Data provided by the authorities; and IMF staff estimates.

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.

2/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Appendix IV. External Sector Assessment[1]

Overall Assessment: *Malaysia's external position in 2023 is preliminarily assessed to be stronger than the level implied by medium-term fundamentals and desirable policies.* The current account surplus, after strengthening due to pandemic-related exports, is expected to narrow in 2023 due to a moderation in external demand. Over the medium-term, the current account surplus is projected to widen as the services balance improves due to a recovery in tourism and as imports moderate.

Potential Policy Responses: In the near-term, flexibility of exchange rate should be preserved to facilitate external adjustments that are driven by fundamentals. Over the medium term, policies should be implemented to strengthen social safety nets and public healthcare, including through a reorientation of fiscal spending. Structural policies should be implemented to encourage private investment and improve productivity growth, including through a reduction in the skills mismatch, improvements in the quality of education, and measures to improve access to credit for SMEs.

Foreign Asset and Liability Position and Trajectory	**Background.** Malaysia's NIIP has averaged about 1 percent of GDP over the last decade, increasing to 5.8 percent at end-2021, supported by strong current account surpluses during the pandemic that helped increase reserve assets. As of end-2022, NIIP declined to 3.0 percent of GDP; however, it increased to 5.2 percent of GDP by end-September 2023 due to an increase in the acquisition of assets abroad in the form of both portfolio and direct investments. Total external debt increased to 69 percent of GDP at end-September 2023, compared to 64 percent at end-2022, and remains manageable. One-third of external debt is ringgit-denominated, hence, not exposed to valuation risks. Short-term external debt, which accounts for 42.3 percent of external debt, is also manageable, as most of it is either in the form of intragroup borrowing (among banks and corporations, and largely stable) or trade credits (backed by export earnings). **Assessment.** Malaysia's NIIP is expected to increase over the medium term, supported by the projected CA surpluses. Malaysia's balance sheet strength, along with exchange rate flexibility and increased domestic investor participation, would help support resilience to a variety of shocks, including outflows associated with external liabilities.
2023 (% GDP)	NIIP: 5.2 / Gross Assets: 131.8 / Debt Assets: 28.5 / Gross Liab.: 126.6 / Debt Liab.: 24.9
Current Account	**Background.** Malaysia's current account (CA) surplus averaged 3.4 percent over the last five years, supported by robust external goods demand during the COVID-19 pandemic, despite a decline in travel receipts. Current account surplus is expected to decline to 2.4 percent of GDP in 2023 due to a moderation in external demand because of a slowdown in major trading partners and a decline in demand for electrical and electronic products amid a global technology downcycle. The moderate declining trend in the current account surplus over the past five years is also reflective of the narrowing savings-investment gap over the same period. **Assessment.** The EBA CA model estimates a cyclically adjusted CA balance of 2.7 percent of GDP and a norm of -0.5 percent, implying a model-assed CA gap of 3.2 percent. Staff assess a CA gap in the range of 2.7–3.7 percent, with a midpoint estimate of 3.2 percent. Relative policy gaps partly explain the CA gap, with weaker social safety nets, proxied by health care expenditure, looser fiscal policies adopted by the rest of the world relative to Malaysia, and increase in BOP reserve assets contributing positively (0.6 percent, 0.6 percent, and 0.4 percent, respectively) to the excess surplus, and stronger credit growth contributing negatively (-0.8 percent). The CA surplus is expected to grow over the medium term, as tourism recovers and improves the services balance.
2023 (% GDP)	CA: 2.4 / Cycl. Adj. CA: 2.7 / EBA Norm: -0.5 / EBA Gap: 3.2 / COVID-19 Adj.: 0.0 / Other Adj.: 0.0 / Staff Gap: 3.2
Real Exchange Rate	**Background.** The ringgit faced depreciation pressures during most of 2023, weakening by almost 5 percent against the US dollar as of end-2023 relative to end-2022. Over the same period, the real effective exchange rate (REER) depreciated by 5.4 percent, while the nominal effective exchange rate depreciated by 4.3 percent, as inflation in Malaysia was lower compared to its major trading partners. **Assessment.** Using a semi-elasticity of 0.5, the staff assessed CA gap implies a REER undervaluation of 6.4 percent in 2023. The REER index and level models estimate Malaysia's REER to be undervalued by 26.7 percent and 29.6 percent, respectively. This implies that, over the medium term, Malaysia's REER needs to appreciate to narrow the CA gap. Staff assess the REER to be undervalued in the range of 5.4–7.4 percent, with a midpoint estimate of 6.4 percent.
Capital and Financial Accounts: Flows and Policy Measures	**Background.** Over the past five years, Malaysia has experienced significant volatility in capital flows, largely driven by portfolio flows in and out of the local-currency debt market, in response to both the change in global financial conditions and domestic factors. The financial account balance averaged -1.1 percent of GDP between 2018 and 2022, while portfolio investments averaged -2.1 percent. **Assessment.** Continued exchange rate flexibility and macroeconomic policy adjustments, such as those prescribed by the IMF's Integrated Policy Framework, are necessary to manage capital flow volatility. Capital flow management (CFM) measures should be gradually phased out, with due regard for market conditions.
FX Intervention and Reserves Level	**Background.** Gross international reserves declined to US$113.5 billion at end-2023, relative to US$114.7 billion at end-2022. In a patter similar to last year, in 2023, against the backdrop of external pressures, reserves decreased through October, but recovered during the last two months of the year, as external pressures eased. **Assessment.** Based on the IMF's composite reserve adequacy metric (ARA), reserves declined to 110 percent of ARA at end-2023, above the adequacy threshold of 100 percent, but marginally lower than 113 percent of ARA at the end of the previous year. This decline is partly driven by an increase in the short-term external debt. The reserve coverage declined to 4.5 months of prospective imports, or about 75 percent of short-term debt. Staff assess that BNM engaged in largely two-sided FX interventions over the year. There is a role for FXI to address disorderly market conditions (DMC) and to respond to large shocks when well-identified and costly frictions are present. FXI is not a substitute for needed policy adjustment, however, and should not be used to lean against exchange rate pressures that are driven by fundamentals.

[1] Prepared by Shujaat Khan. The assessment is preliminary, pending a complete analysis in the July 2024 External Sector Report.

Appendix V. Risk Assessment Matrix[1]

Risks	Likelihood and Transmission	Expected Impact of Risk	Recommended Policy Responses
External risks			
Abrupt growth slowdown or recession in China	**Medium** Sharper-than-expected slowdown in the property sector, unexpected fiscal tightening due to local government financing stress and decline in investment, and/or rising geopolitical tensions disrupt economic activity.	**Medium** China is Malaysia's largest trading partner. Staff estimated in the 2012 Spillover Report that a 1 percentage point investment slowdown in China would reduce Malaysia's growth by 0.6 percentage points. The impact would be compounded by spillover effects in other Asian countries strongly integrated with both China and Malaysia, particularly ASEAN countries.	The exchange rate should be the first line of defense to absorb the shock, using reserves to smooth excessive volatility. Targeted fiscal policy support can also play some role in minimizing scarring impact, although fiscal buffers are limited. Structural policies could be implemented to minimize scarring and rebalance growth towards domestic demand.
Commodity price volatility.	**High** A succession of supply disruptions (e.g., due to conflicts, uncertainty, and export restrictions) and demand fluctuations causes recurrent commodity price volatility, external and fiscal pressures.	**Medium** Commodity price volatility by inducing higher uncertainty could weigh on economic activity and put pressure on fiscal policy given reliance on petroleum-related revenues.	Rebuild fiscal buffers amid uncertainties and fiscal reforms to continue reducing the reliance on petroleum-related revenues, such as broad-based taxes, are critical. Investment in infrastructure and other productivity-boosting structural reforms could also help.
Monetary policy miscalibration	**Medium** Amid high economic uncertainty and volatility, major central banks slow monetary policy tightening or pivot to loosen monetary policy stance prematurely, de-anchoring inflation expectations and triggering a wage-price spiral in tight labor markets.	**Medium/High** Impact on Malaysia would be mainly through the interest rate differential with central banks in AEs, enter a new tightening cycle, the resulting outflows and depreciation of the Ringgit and, through the upward pressure on the bond yields but also resulting weak external demand. High public debt is a vulnerability. Limited external financing and weak workers bargaining power are mitigating factors.	Monetary policy should be calibrated to balance the trade-off between supporting growth, taming inflation and managing capital outflows. With limited fiscal buffers, any temporary fiscal expansion should be well targeted and anchored in a credible medium term fiscal consolidation plan. Liquidity support (including FX) could be provided. Temporary outflow CFMs could be also considered under imminent crisis circumstances, as part of a broader policy package in line with the Fund's institutional view (IV).
Deepening geoeconomic fragmentation.	**High** Broader and deeper conflict(s) and weakened international cooperation result in a more rapid reconfiguration of trade and FDI, supply disruptions, protectionism, technological and payments systems fragmentation, rising input costs, financial instability, a fracturing of international monetary and financial systems, and lower potential growth.	**Medium/High** With a highly open economy and as a key player in global supply chains of semi-conductors, reconfiguration of trade and supply disruptions threaten to negatively impact the economic activity through its impact on the manufacturing/Electronics sector.	A continued careful and orderly reopening of the economy especially targeting sectors well integrated into the global value chains would help mitigate the impact of this shock.
Extreme climate events.	**Medium** Extreme climate events driven by rising temperatures cause loss of human lives, severe damage to infrastructure, supply disruptions, lower growth.	**Medium** Severe flood events could destroy infrastructure and capital and necessitate relief and recovery spending, negatively impacting output and reducing further fiscal space.	Continue and accelerate the development and implementation of climate mitigation and adaptation plans, including 12MP improvements to early warning systems and disaster response measures.

[1] Prepared by Kodjovi Eklou. The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

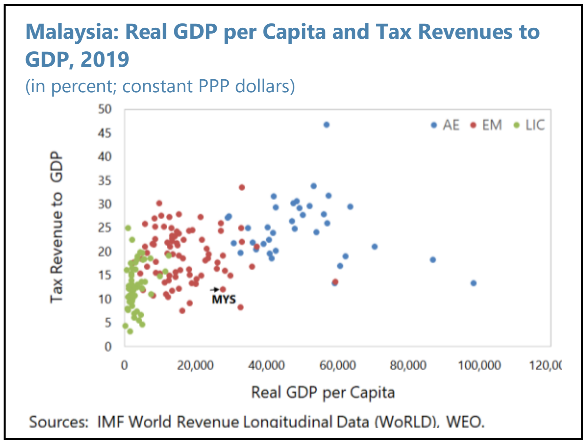
Risks	Likelihood and Transmission	Expected Impact of Risk	Recommended Policy Responses
Domestic risks			
Fiscal risks from contingent liabilities (Short- to medium-term).	**Medium** Realization of contingent liability risks, with the government stepping in to fulfill obligations of recipients of government guarantees, would have adverse consequences for fiscal policy, raising the sovereign's financing cost and requiring even stronger fiscal adjustment to restore fiscal sustainability.	**Medium/High** Realization of contingent liabilities would raise sovereign financing costs and public debt, exacerbating concerns about public debt sustainability and could lead to an adverse feedback loop of spikes in domestic interest rates and exit of foreign investors.	The authorities' ability to mount countercyclical responses would be boosted by medium-term fiscal consolidation most notably through a medium-term revenue strategy (MTRS). Continued progress in reforming fiscal institutions can mitigate the impact, including improving the fiscal risks management framework and publication of annual fiscal risks statement, along with increased transparency of GLC operations.
Cyberthreats	**Medium** Cyberattacks on physical or digital infrastructure (including digital currency and crypto assets ecosystems) or misuse of AI technologies trigger financial and economic instability.	**Medium/High** Disruptions in secure remote work from home, theft of personal information, SWIFT fraud, hacked crypto-asset exchanges, and business disruptions across the supply chain could materialize.	Continued investment in the cyber security strategy. Existing IT security frameworks could be strengthened, and new lines of defense could be built to eliminate the risk of such attacks based on the improvement in cyber risk surveillance efforts via the introduction of a set of Cyber Key Risk Indicators (KRIs) and minimize their impact in line with the recent FinTIP.

Appendix VI. Raising Revenues for a Sustainable Future[1]

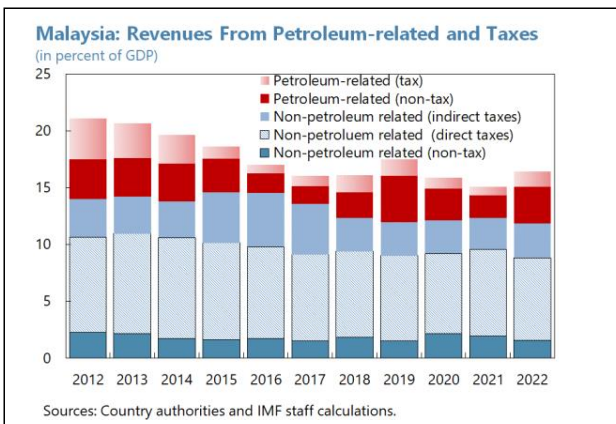
Domestic revenue mobilization is one of Malaysia's most urgent challenges. Trapped in an equilibrium of low and declining tax revenues in percent of GDP and in middle-income status, achieving progress on this front is crucial to fund its aspiration of becoming a high-income nation. This appendix proposes a revenue target for Malaysia based on its economic and institutional characteristics. It assesses the performance of the 2015 goods and services tax (GST) and addresses some of the key concerns around its reintroduction.

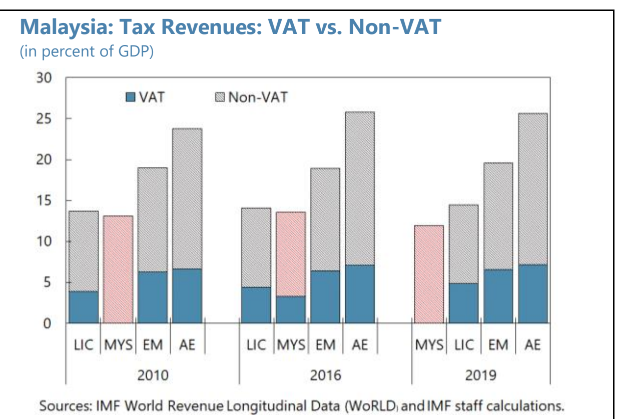
A. Malaysia's Tax Revenues and Potential

1. **Malaysia has not fully exploited its revenue potential compared to other emerging markets economies with similar income levels**. The level of per capita income, a proxy for the degree of overall economic development, is positively correlated with tax revenues: a high level of development brings more demand for public expenditure and a higher level of tax capacity to pay for the higher expenditure. Malaysia's tax to GDP ratio is the lowest compared to countries around its income level, with many lower-income countries achieving higher tax collection.



2. **Malaysia's tax revenues have been declining in the past decades.** Notable progress on decreasing reliance on petroleum-related revenues has been achieved, with its share in total revenues dropping from 34 percent in 2012 and to 18 percent in 2021. However, at the same time, tax revenue collection weakened over time to less than 12 percent of GDP in 2022, down from over 15 percent a decade ago. This has made Malaysia's tax performance more comparable to low-income than emerging market peers. One notable period in Malaysia's taxation history is the introduction of a good and services tax (GST) during 2015-2017, which increased Malaysia's tax collection by about 3 percentage points of GDP per year.





[1] Prepared by Ghada Fayad and Yue Zhou.

3. Malaysia could potentially collect about 15 percent of tax revenue to GDP in the short to medium term. Tax frontier analysis is used to estimate tax potential for Malaysia. Such analysis argues that the level of tax revenue that a country could raise is constrained by its administrative, monitoring, and enforcement capabilities and the nature of its economy, structural, and institutional characteristics (Lotz and Morss ,1967; Bird et al., 2008; Fenochietto and Pessino, 2013; IMF, 2018a; and IMF, 2022). Key determinants of tax capacity include GDP per capita, openness to trade, the share of agriculture in GDP, control of corruption and government effectiveness. Consistent with other studies, the analysis finds that higher income level is associated with higher tax collection but the effect of higher income on tax collection is non-linear. Strong control of corruption and openness to international trade are also associated with higher tax collection. However, a higher share of agriculture in GDP (associated with more informality) is associated with lower tax collection. The estimated coefficients are significant at the 1 percent level, except for the government effectiveness and commodity exporter dummy (which however mostly have the expected signs) (Table 1). The coefficients, across different samples, are used to estimate the tax capacity for each country. Malaysia's estimated tax capacity ranges from 15.1 to 15.4 percent.

Malaysia: Tax Capacity Across Income Groups

Tax capacity	All sample	EMDCs	EMs
AE	26.9		
EM	19.3	19.3	18.9
LIC	13.1	13.4	
MYS	15.3	15.4	15.1

Table 1. Malaysia: Tax Frontier Regression Results

Dependent variable: log of tax to GDP	All sample		EMDCs		EMs	
Explanatory variables	Coefficient	Std. error	Coefficient	Std. error	Coefficient	Std. error
Log of real GDP per capita	0.661	0.062	0.877	0.082	0.626	0.103
Log of real GDP per capita squared	-0.035	0.035	-0.053	0.005	-0.034	0.005
Share of agricutlure in GDP	-0.013	0.001	-0.018	0.001	-0.015	0.003
Trade openness	0.001	0.000	0.001	0.000	0.001	0.000
Control of corruption	0.046	0.015	0.063	0.019	0.059	0.023
Government effectiveness	-0.001	0.014	0.021	0.019	0.012	0.022
Commodity exporter dummy	-0.069	0.274	-0.115	0.349	0.257	0.533
sigma_u	0.134	0.076	0.140	0.006	0.106	0.007
sigma_v	0.097	0.073	0.124	0.004	0.135	0.004
No. of observations	3409		2654		1648	
No. of countries	174		138		84	

Sources: World Bank World Development Indicators, IMF WEO, IMF World Revenue Longitudinal Data (WoRLD), and IMF staff estimates.
Note: Trade openness is measured as the sum of exports and imports of goods and services as percentage of GDP. Both control of corruption and government effectiveness indices range from –2.5 (high corruption, low effectiveness) to 2.5 (low corruption, high effectiveness)

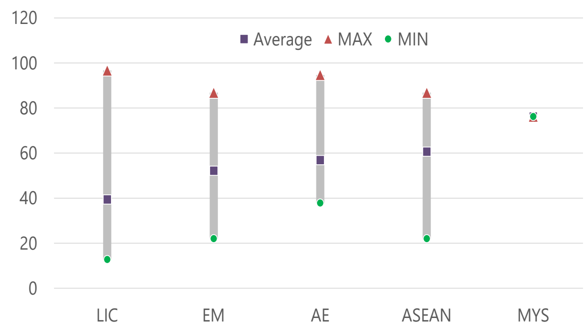
B. GST Re-Introduction: Looking at the Past to Inform the Future

Malaysia's Past Experience with the GST

4. **Given its importance as a powerful potential revenue measure, assessing the efficiency of the 2015 GST can help inform and improve its reintroduction**. Keen (2013) sets out the compliance efficiency (C-efficiency) tool for understanding the performance of GST. C-efficiency is an indicator of the departure of GST from a perfectly enforced tax levied at a uniform rate on all consumption. As such the C-efficiency ratio is calculated as the ratio of actual VAT revenues collected over the VAT rate applied to final consumption expenditure exclusive of collected VAT.

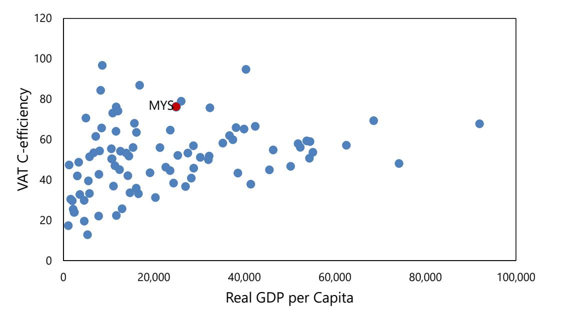
5. **While the 2015 transition from the sales and services tax (SST) to GST had been generally successful, there is room to improve the efficiency and administration of the GST.** Focusing on the period 2015-2017 when the GST was in effect, we compute the C-efficiency and compare it to that of peers and across income groups. Over that period, and given the standard rate of 6 percent, Malaysia could have collected about 4 percentage points of GDP in GST revenue, compared to an average 3 percentage points collected, putting its C-efficiency at about 75 percent. This score compares favorably to that of peers. In fact, for at its income level, a measure that is positively correlated with C-efficiency, Malaysia's score is among the highest.

Malaysia: VAT C-efficiency Across Income Groups, 2015–2017



Sources: IMF World Revenue Longitudinal Data (WoRLD), WEO, and IMF staff calculations.

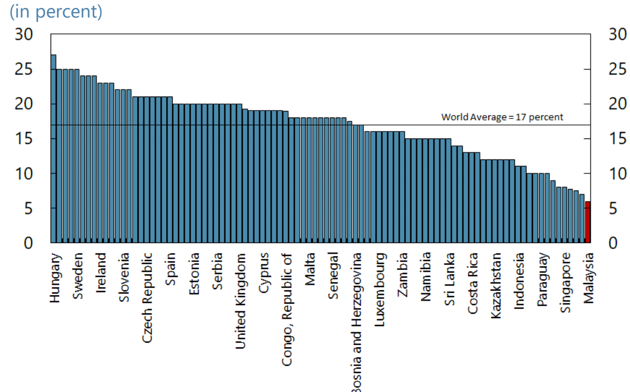
Malaysia: VAT C-efficiency vs. Real GDP per Capita
(in percent, 2015-2017)



Sources: IMF World Revenue Longitudinal Data (WoRLD), WEO, and IMF staff calculations.

6. **The gap between C-efficiency ratios and a perfect score can be explained by policy and compliance gaps.** Policy gaps pertain to issues related to the design of the VAT/GST, for instance the VAT rate and to exemptions granted. Compliance gaps are linked to implementation of the tax. Continued focus on improving revenue administration as well as on reducing leakages and tax expenditures can help increase the c-efficiency of the GST. In that respect, while zero-rating of the multiple food items that

Malaysia: VAT Rates Across the World
(in percent)



Sources: PWC, and country authorities.

make up a larger share of the consumption by the poor was believed to mitigate regressivity concerns, such exemptions also benefit the rich, whose consumption of food items is high, and thus cost significant revenues. Instead, the poor can be supported more efficiently by a combination of progressive income taxes and cash transfers (De Mooij and Swistak, 2022).

Cross-Country Evidence on the Distributional Impact of GST

7. Notwithstanding its widespread adoption and global dominance in revenue generation, VAT's perceived natural regressivity has been put forward as a major limitation. More than 170 countries have adopted a VAT on goods and services, and OECD countries are estimated to collect about 20 percent of their revenues from VAT (OECD, 2022). For EMs and LICs, about 30 percent of total revenues came from VAT. Being a tax on consumption and given higher marginal propensity to consume at lower income levels, the GST is considered regressive. Since it is also based on anonymous transactions rather than finer indicators of ability to pay, it is hard for internal VAT design to be tailored to serve equity concerns. Despite the growing literature, the empirical evidence on VAT regressivity is not yet settled.

8. VAT is found to be regressive when assessed relative to current income, and neutral or even mildly progressive when assessed relative to current consumption instead. Proponents of measuring VAT burdens as a percentage of current expenditure instead of current income argue that the income-based approach fails to account for savings behavior, for example the fact that income that is saved in the current year will still incur VAT when it is eventually consumed. Because savings rates tend to increase with income, this biases income-based VAT burden results downwards at higher income levels – hence the common conclusion that the VAT is regressive (Leahy et al. (2011) for Ireland; Ruiz and Trannoy (2008) for France; O'Donoghue et al. (2004) for 12 European countries). Studies that instead use the expenditure-based approach find that VAT systems are relatively proportional, or even slightly progressive. (Bird and Smart (2016) for Canada; IFS (2011) for 6 European countries; Thomas (2022) for OECD countries).

9. Other issues with measuring the incidence of the VAT may suggest that it is not as regressive as presumed to be. These relate to uncaptured further effects at work including the VAT registration threshold, which implies that sales by small retailers where the poorest often buy are VAT exempt. Such moderating impact, when possible to estimate, has been found to be substantial. To the extent that the benefits of non-registration are not passed on the consumer, they likely remain with the seller, who in turn is also likely to be of relatively low income. Food production for home consumption is also de facto exempt, with similar effect (IMF, 2019a).

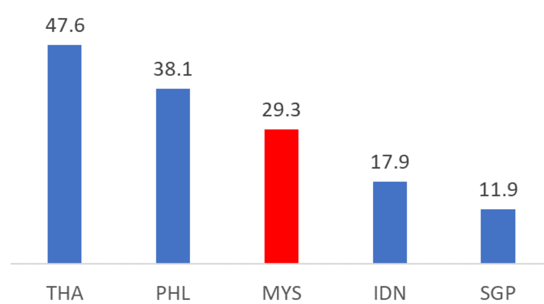
10. Assessing the distributional impact of the VAT, inclusive of that of the targeted public spending that the revenues collected could finance points, to a more progressive VAT. Fundamentally, rather than any one tax, it is the tax and public spending system that affects and matters for equity. In theory, a regressive tax could be the best way to finance pro-poor spending, which more than offsets any anti-poor effect of the tax itself (Ebrill et al. 2002). Expenditure policies are also more suited to address distributional issues through well-targeted spending measures. A large number of studies, using applications of a general equilibrium model-based analysis on fiscal reforms and inequality in low income and developing countries (Fabrizio et al., 2017), find that VAT is a preferred reform option regarding the economic and distributional impact, if complemented by mitigating spending measures (Honduras and Uganda (Fabrizio et al., 2017); Benin (IMF, 2018b), Senegal (IMF, 2019b), and Cambodia (Hansen and Gjonbalaj, 2019).)

11. Lastly and as argued in IMF (2019a), no other more progressive and practicable instrument capable of raising comparable amounts of much needed revenue has been identified as an alternative to the VAT. Malaysia's recent focus on progressivity, through progressive changes in personal income tax rates under the 2023 Budget and ongoing subsidy reform under the 2024 Budget are all welcome steps in building a progressive fiscal setup, capable of identifying and supporting lower-income households, and supportive of an eventual re-introduction of the GST.

GST and Formality

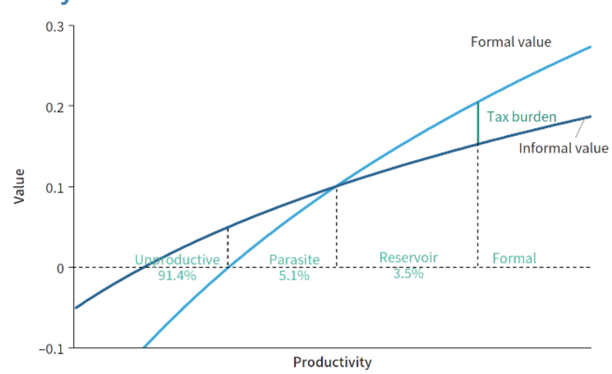
12. The informal sector plays an important role in the Malaysian economy. As in many developing countries, the informal sector accounts for a significant part of economic activities, with one third of outputs attributed to the sector. It also provides livelihood for millions of people as 25 percent of the employees are self-employed and half of the employees are not covered by pension.

Malaysia: Share of Informal Sector Output
(in percent of GDP)



Source: Elgin et al. (2021).

Malaysia: Illustration of Informal Firms in India



Source: Zhou (2021).

13. While the role of the informal sector remains controversial, some literature finds that the informal sector arises out of poverty and low productivity. The informal sector can be categorized into three types: reservoir, parasite, and unproductive. The reservoir-type of informal firms are capitalists-in-waiting who cannot join the formal sector because of high entry costs (De Soto, 1989; Tokman, 2007). Parasite firms can survive as formal firms if all tax burdens are removed, but they nonetheless remain informal. Unproductive-type firms can survive only as informal firms. While detailed analysis is needed to understand the informal sector in Malaysia, there is growing evidence that most informal firms are unproductive with limited competitiveness to survive in the formal sector (Kanbur, 2017; La Porta and Schleifer, 2014; Levy, 2008, Maloney, 2004, Ulyssea, 2018).

14. The presence of informality poses severe challenges to enforcing taxation, particularly in developing countries. Governments need to be able to observe transactions in the economy in order to be able to impose taxation. However, in the context of informality, many transactions in the informal economy are not readily observable by the government, which partly explains the different tax performance between advanced and developing economies.

15. Introducing the GST can reduce tax avoidance because of its self-enforcing nature. GST could facilitate enforcement through a built-in incentive structure that generates a third-party reported paper trail on transactions between firms, which makes it harder to hide the transaction from the government (Keen, 2010; Pomeranz, 2015). Specifically, the self-enforcement of GST is based on the idea that firms have an incentive to ask their suppliers for receipts because they can deduct input costs from their VAT bill. This incentive builds the creation of paper trails directly into the tax structure. Since the amounts are recorded in two sets of books from sellers and buyers, the risk of cross-checks is thought to deter firms from reporting differing amounts.[2]

16. While replacing a cascading sales tax with a GST would have a relatively small effect on the number of formal firms, it would have a much larger effect on formal sector output (Zhou, 2023). By streamlining the tax system to avoid double taxation at every stage of production, the VAT promotes the expansion of productive formal firms, leading them to absorb labor and capital from the informal sector. It is through this reallocation process that VAT adoption can have a positive effect on economic growth and structural transformation.

17. Replacing a cascading sales tax with a GST could also boost revenues through higher output and labor income. The literature suggests that if tax rates and formal economic activity are kept constant, moving from a cascading sales tax to a VAT leads to lower tax revenues. However, other factors are not constant. For example, VAT adoption has a positive effect on labor income and formal sector profits. The analysis shows that higher corporate and income tax revenues more than offset the loss in tax revenue associated with the transition from the cascading sales tax to the VAT.

C. Conclusions

18. The time is right for Malaysia to forcefully address its revenue weakness problem to help forge ahead with its development spending needs and achieve high-income status. This appendix proposes a feasible revenue target for Malaysia based on its economic and institutional characteristics and considers the re-introduction of the GST to help reach that target. It assesses the performance of the 2015 GST and addresses concerns around its reintroduction related to its regressivity. In doing so, it presents methodological issues related to this assessment and concludes, among other things, that assessing the distributional impact of the GST inclusive of that of the targeted public spending that the revenues collected could finance points to a more progressive VAT. Finally, it also reviews evidence on the link between GST and reducing tax avoidance and increasing formal sector output.

[2] An important feature of this mechanism is that the two sides of a transaction in inter-business trade have opposing incentives: the buyer benefits from overstating the input cost, while the seller benefits from understating the sale. In the middle of the VAT chain, there is therefore no scope for gains from collusion between the two parties.

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Appendix VII. Aiming for High-Income Status: Potential Gains from Structural Reforms in Malaysia[1]

Many EMDEs, including Malaysia, came out of the COVID-19 pandemic with limited policy space, while also facing challenges of low growth, high inflation, high debt and external pressures to various degrees. At the same time, Malaysia has the ambition to become a high-income country. In line with some of the objectives outlined in the government's strategic policy documents (Malaysia 12th plan, MADANI Economy framework), this appendix discusses potential gains for output, female labor force participation, and green growth from the implementation of structural reforms drawing from a recent IMF SDN.[2] The appendix also discusses the sequencing and packaging of reforms to accelerate growth and ease policy trade-offs. Compared to the average emerging market, Malaysia would likely gain more from structural reforms given its structural characteristics, and such reforms could also lift wage growth and enhance economic complexity in Malaysia.

A. Background: Taking Stock of Progress Made and Structural Gaps in Malaysia

1. **Malaysia made significant progress over the last decades and is getting close to a high-income status.** As of 2022, GDP per capita in Malaysia reached about 45 percent relative to US from below 20 percent in 1962–1973, suggesting a strong convergence vis-à-vis the US. This was supported by strong GDP per capita growth averaging 3.7 percent over the period 1963–2022, albeit slowing down during major recessions including the COVID-19 pandemic (See figure 1 in Annex 1). Malaysia leads its geographic and income level peers with its six decades average GDP per capita growth versus ASEAN-5 (3.4 percent), Emerging Asia (2.7 percent), and EMDEs (1.9 percent) (see Figure 1). Since 1987, Malaysia has been an upper-middle income country and GNI per capita in 2022 was about 6 times higher. While the pandemic has slightly slowed Malaysia's progress toward high-income status, this objective remains achievable given that as of 2022, the country is about 2,066 USD from the current threshold that defines a high-income economy (see Figure 2).

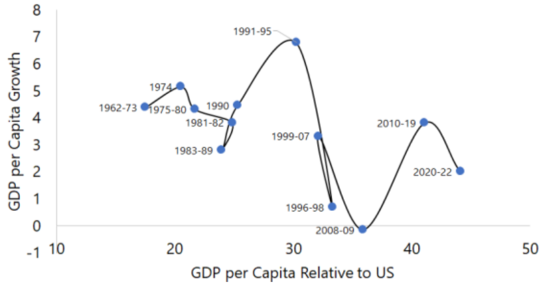
2. **Structural reforms are needed to achieve the aspirations in the MADANI Economy framework amid structural gaps and limited policy space.** Structural gaps increased at the height of the COVID-19 pandemic in Malaysia and ASEAN-4 peers. Whether measured relative to the global frontier or relative to the top EMDE frontier, structural gaps have increased in Malaysia during the COVID-19 pandemic, reverting the progress made from 2010 to 2019. This is the case across all structural reform dimensions and across ASEAN-4 peers. Compared to the ASEAN-4 peers however, structural gaps are lower in Malaysia with an exception for climate related policies (see Figure 4 and 5). Further, policy trade-offs have risen post-pandemic mainly in terms of narrow fiscal space and increased exchange market pressure in Malaysia (see Figure 3). There is therefore room for more structural reforms to reduce gaps in particular in the area of climate and green policies, and ease policy trade-offs in Malaysia.

[1] Prepared by Kodjovi Eklou, Ganchimeg Ganpurev, and Shujaat Khan.

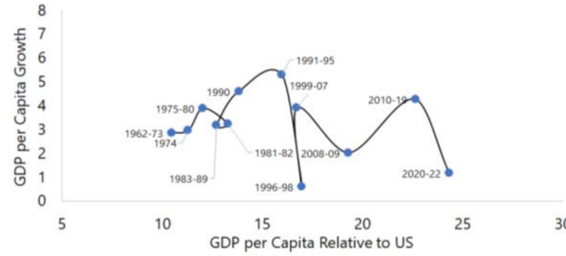
[2] The appendix leverages partly on work done by Budina, Ebeke, Jaumotte, Medici, Panton, Tavares and Yao (2023).

Figure 1. Malaysia and Peers: Convergence Toward the US Over Time

Malaysia: Convergence to U.S. GDP per Capita
(in percent)

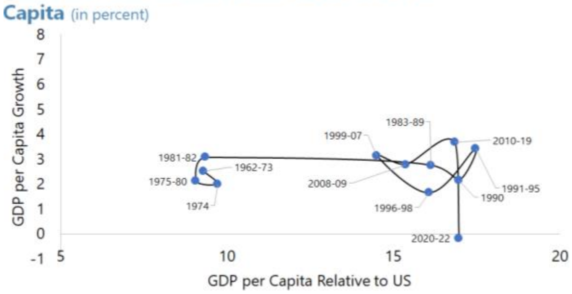


ASEAN-5: Convergence to U.S. GDP per Capita
(in percent)

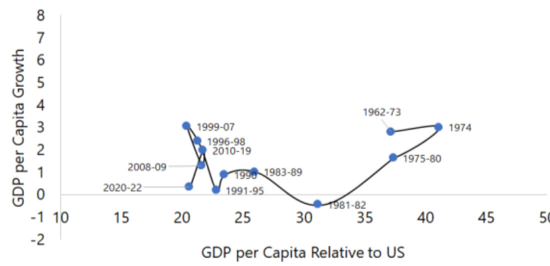


Note: ASEAN-5 includes Indonesia, Malaysia, Philippines, Thailand, and Vietnam.

Emerging Asia: Convergence to U.S. GDP per Capita (in percent)



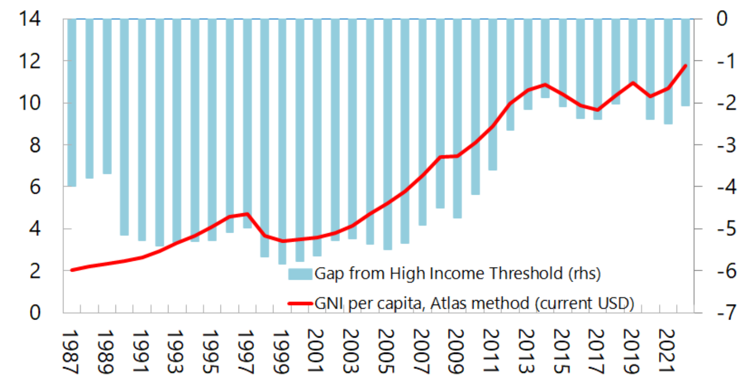
EMDEs: Convergence to U.S. GDP per Capita
(in percent)



Sources: IMF WEO October 2023 and IMF staff calculations.
Note: Global recessions were taken following NBER definition and Kose et al. (2020).

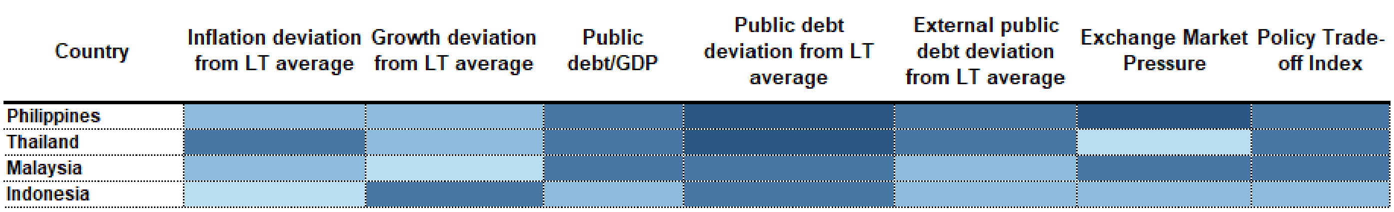
Figure 2. Malaysia: Convergence Toward the High-Income Status

Malaysia: Gross National Income per Capita
(in thousands)



Sources: World Bank Development Indicator and IMF Staff calculations.

Figure 3. ASEAN4: Policy-Trade Off Heatmap

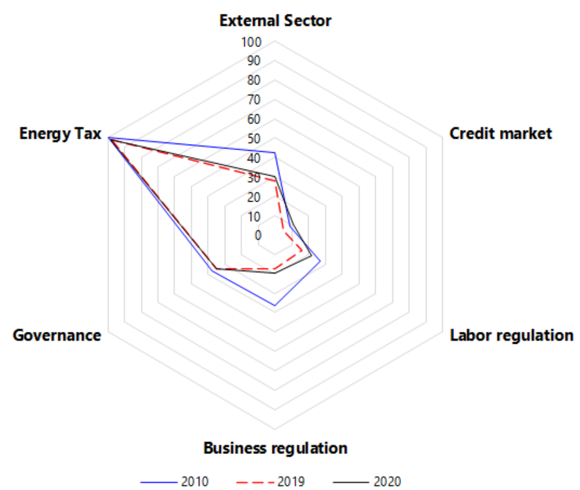


Note: The Policy Trade-off Index is obtained as a first principal component of inflation (deviation from its long-term average), growth (deviation from its long-term average), public debt (level and its deviation from long-term average), external public debt (deviation from its long-term average) and exchange market pressure. The indicators are constructed using 2022-2023 average in a sample of 58 large EMs. Color coding is by quartile, with darker color standing for more acute policy trade-off.

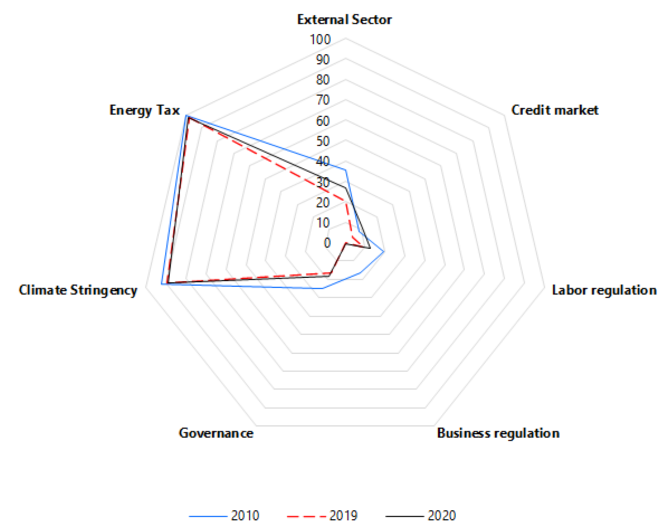
Source: Budina, Ebeke, Jaumotte, Medici, Panton, Tavares and Yao (2023). Structural Reforms to Accelerate Growth, Ease Policy Trade-offs, and Support the Green Transition in Emerging Market and Developing Economies. *Staff Discussion Notes*, *2023*(007).

Figure 4. Malaysia: Structural Gaps

Malaysia: Structural Gaps in Malaysia Compared to Global Frontier



Malaysia: Structural Gaps in Malaysia Compared to EMDEs Frontier

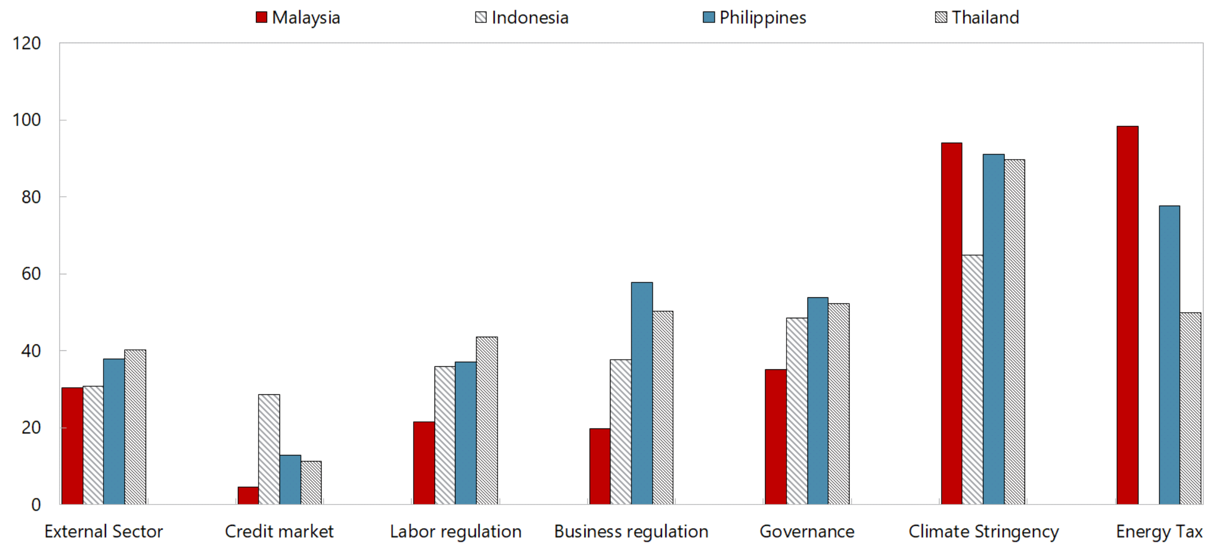


Note: Structural gaps are obtained as deviations from the frontier (the top performer in each macro-structural area in each year), in percent. Note that from IMF climate change indicators dashboard, MYS does not have energy tax revenues until 2018, hence a gap of 100 percent in 2010.
Source: Budina et al. (2023).

Figure 5. ASEAN4: Structural Reform Gaps Compared to Peers

ASEAN-4: Structural Gaps Compared to Global Frontier (2020)

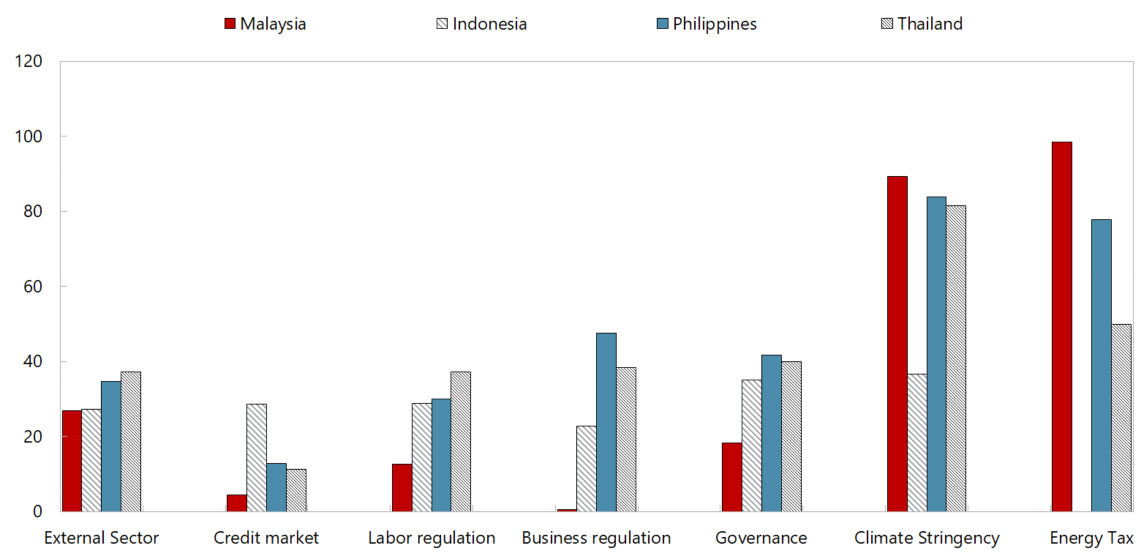
(in percent)



Note: Structural gaps are obtained as deviations from the frontier (the top performer in each macro-structural area in each year), in percent. Note that from IMF climate change indicators dashboard, MYS does not have energy tax revenues until 2018, hence a gap of 100 percent in 2010.
Source: Budina et al. (2023).

ASEAN-4: Structural Gaps Compared to EMDEs Frontier (2020)

(in percent)



Note: Structural gaps are obtained as deviations from the frontier (the top performer in each macro-structural area in each year), in percent. Note that from IMF climate change indicators dashboard, MYS does not have energy tax revenues until 2018, hence a gap of 100 percent in 2010.
Source: Budina et al. (2023).

B. What are the Potential Gains from Structural Reforms in Malaysia?

The Gains from Structural Reforms in Emerging Markets and Developing Economies

3. **Macrostructural reforms are shown to help accelerate growth, particularly in EMDEs that have a high productivity gap, and can also help achieve broader policy objectives.** Budina et al. (2023) estimate the impact of different structural reforms on growth in EMDEs. The study finds that four years after their implementation, governance, external sector, business regulation, and credit market regulation reforms increase output by up to 2.7 percent, 2.4 percent, 1.3 percent, and 2 percent, respectively. In countries that have a high labor productivity gap, the growth impact after four years accentuates further for governance (about 4 percent), external sector (about 4.5 percent) and business regulation reforms (about 2 percent). Structural reforms also have the potential to achieve broader policy objectives of price stability and external resilience.

4. **The packaging and sequencing of reforms can play an important role in not just amplifying their growth impact, but in also easing policy trade-offs.** A bundling of reforms that are complementary can frontload output gains, which helps with political buy-in and increases the likelihood of the effectiveness of additional reforms. In this context, Budina et al. (2023) find that output growth can be accelerated if governance, business regulation, and external sector reforms (referred to as first-generation reform package) are bundled and frontloaded. The estimated output gains from the implementation of the first-generation reforms are amplified even further if the EMDE has initial structural gaps, with output projected to increase by 4 percent in the first two years and rising to 8 percent after four years. Besides raising growth, these reforms can also assist in removing binding constraints (for example, by reducing bureaucratic constraints, improving competitive environment, instilling greater certainty, and reducing informality), which can lead to an increase in the effectiveness of credit and labor market reforms (second-generation reforms).

5. **Appropriate sequencing of reforms can also have a positive impact on increasing female labor participation.** Estimates made by Budina et al. (2023) suggest that first-generation reforms can help improve the accumulation of human capital by increasing both male and female secondary education enrollment and by boosting tertiary education enrollment for women. Moreover, in countries where first-generation reforms have been implemented, labor market reforms also contribute to the improvement of labor force participation, particularly amongst women, in both the short and medium-term. This may be because the first-generation reforms could help in the reduction of the degree of informality in the labor markets and promote better working conditions and reduce workplace discrimination. When combined, the improvement in educational outcomes and a reduction in the gender gap in labor force participation, could provide a long-term boost to growth.

6. **Macrostructural reforms also have the potential for promoting green growth in EMDEs.** While first-generation structural reforms boost output, leading to an increase in overall GHG emissions, estimates suggest that the energy and GHG emissions intensity of GDP also declines. Moreover, there is an increase in the share of renewables in the energy mix. These effects are more pronounced in countries that have higher initial structural gaps. Since green sectors in

EMDEs tend to face an array of constraints, structural reforms, by removing impediments to private sector investments, can support greater diversification of the economy towards green and less carbon-intensive sectors. Additionally, structural reforms can also increase the effectiveness of green policies such as energy taxes at decarbonizing the economy. Estimates suggest that for countries in the top-quartile of successful implementation of first-generation structural reforms, an increase in the energy tax can have a significant impact on reducing GHG emissions and GHG emissions intensity of GDP, while also increasing the share of renewables in the energy mix.

Malaysia: Structural Characteristics and Gains from Structural Reforms

7. We investigate the gains from structural reforms taking into account key structural characteristics of Malaysia such as high informality, high household debt and high corporate debt. Following the Appendix V of IMF Country Report No. 22/126 showing that high household debt and corporate debt have contributed historically to a larger output scarring in Malaysia, compared to median EM, we explore to what extent these could shape the gains from structural reforms. Indeed, Garrido et al. (2020) show that household debt tends to induce larger drag on future GDP growth than corporate debt, because of the high propensity to consume among debtors – which leads to vulnerabilities from household debt to build up faster if expenditure outpaces disposable income (Garber et al, 2019, Mian and Sufi, 2018). Further, informality could also amplify scarring as workers in the informal sector tend to enjoy less access to social safety nets including limited access to credit. Similar to Budina et al., (2023) we estimate therefore the following equation, in a sample of 75 EMs over the period 2000-2020, (including Malaysia) to test whether gains from structural reforms could be larger under these structural conditions that could also be seen as initial structural gaps:

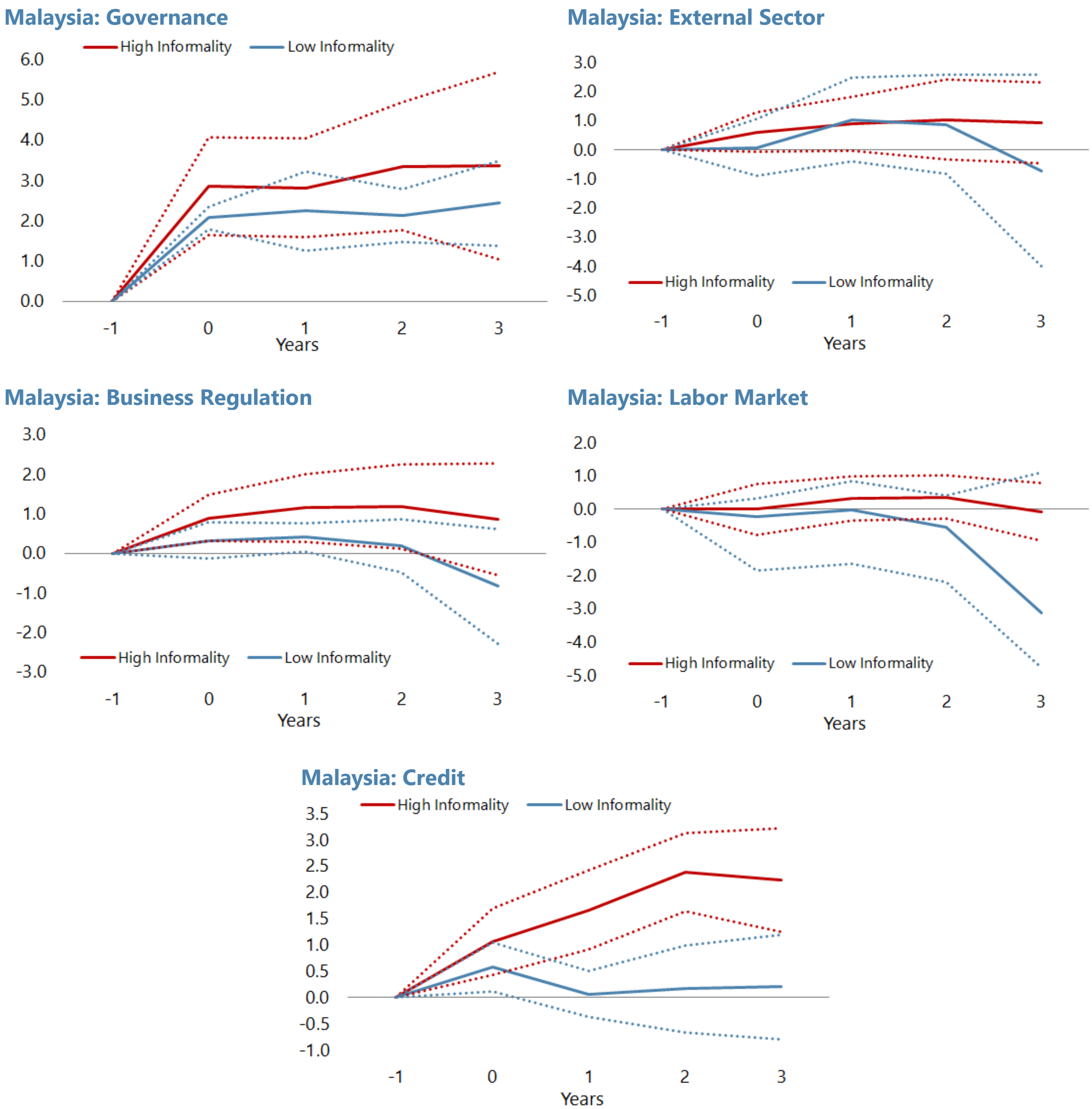
$$Y_{c,t+h} - Y_{c,t-1} = \alpha_c + \tau_t + \beta_h SR_{ct} + \theta(SR_{ct} \times G_{ct}) + \gamma X_{ct} + \varepsilon_{ct}$$

where G_{ct} captures whether a country belongs to high or low structural characteristic group (e.g., high informality or low informality). High (informality, household debt and corporate debt) group is defined as country-year with a value above the sample median and Low as below the sample median. SR stands for structural reform (see Annex 2 for a detail on structural reform variables used in the analysis), and $Y_{c,t+h}$ is the logarithm of output in country *c,* year *t* and horizon *h*. The horizons h=0, 1, 2, 3. X is a set of control variables including lags of the dependent variable, past economic growth, and past reforms, while α_c , τ_t denote country fixed effects and year fixed effects respectively.

8. Our results in Figure 6 to 8 show that the gains from structural reforms could be larger compared to the average EM given large initial structural gaps as captured by high household debt, high corporate debt, and high informality. The results suggest that some specific structural reforms are likely to generate large gains in output given Malaysia's initial conditions:

- **a.** *Informality*: governance, business regulation and credit market
- ***b.*** *High household debt:* Labor market and credit
- **c.** *High Corporate debt:* governance, credit, labor market and business

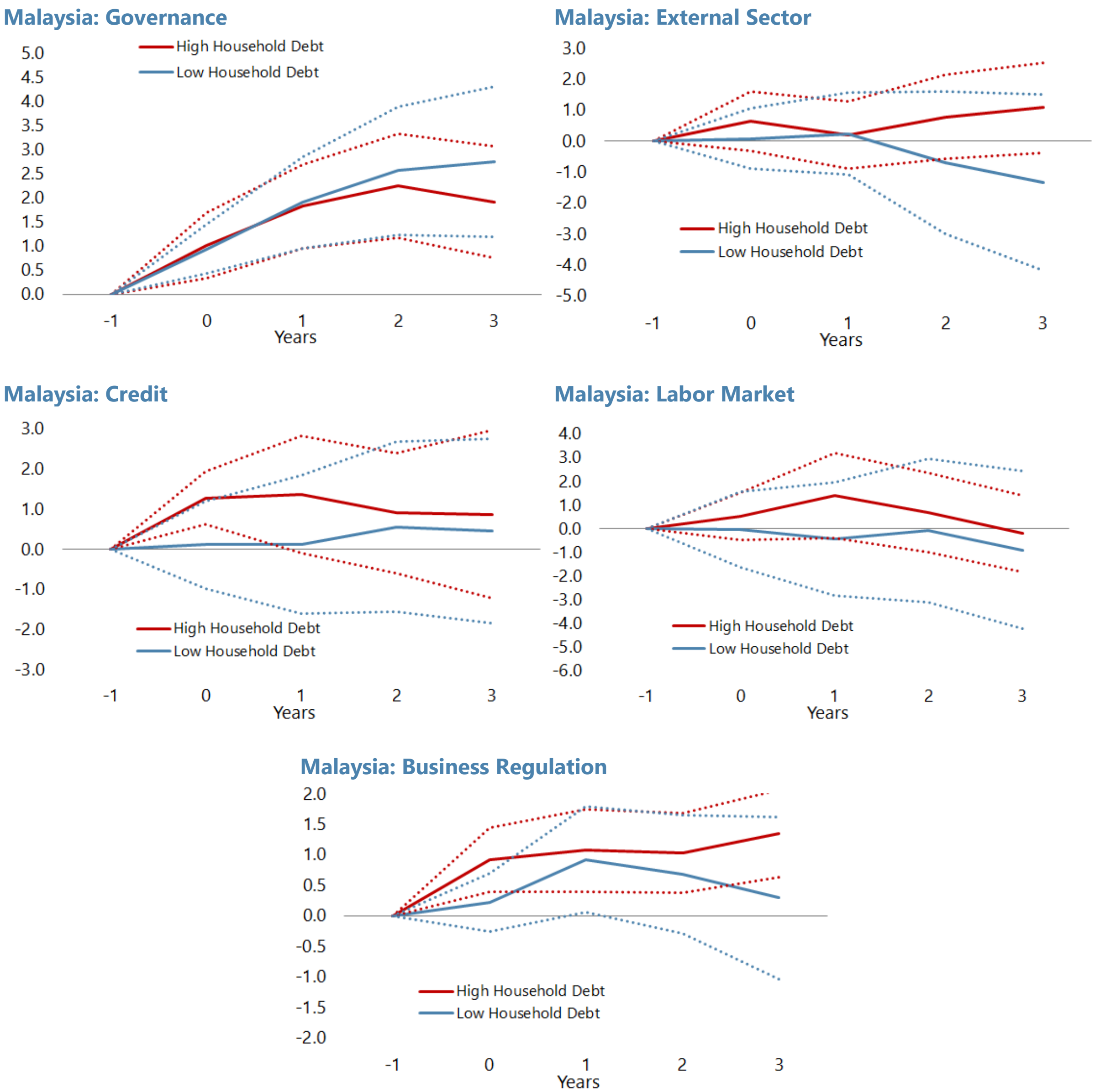
Figure 6. Malaysia: Structural Reform and Output Growth—The Role of Informality



Sources: World Bank, Fraser Institute, and IMF staff calculations.

Notes: 90 percent confidence interval from Kraay and Driscoll standard errors in dashed lines. Marginal Impact is in percent. t = 0 is the year of the shock.

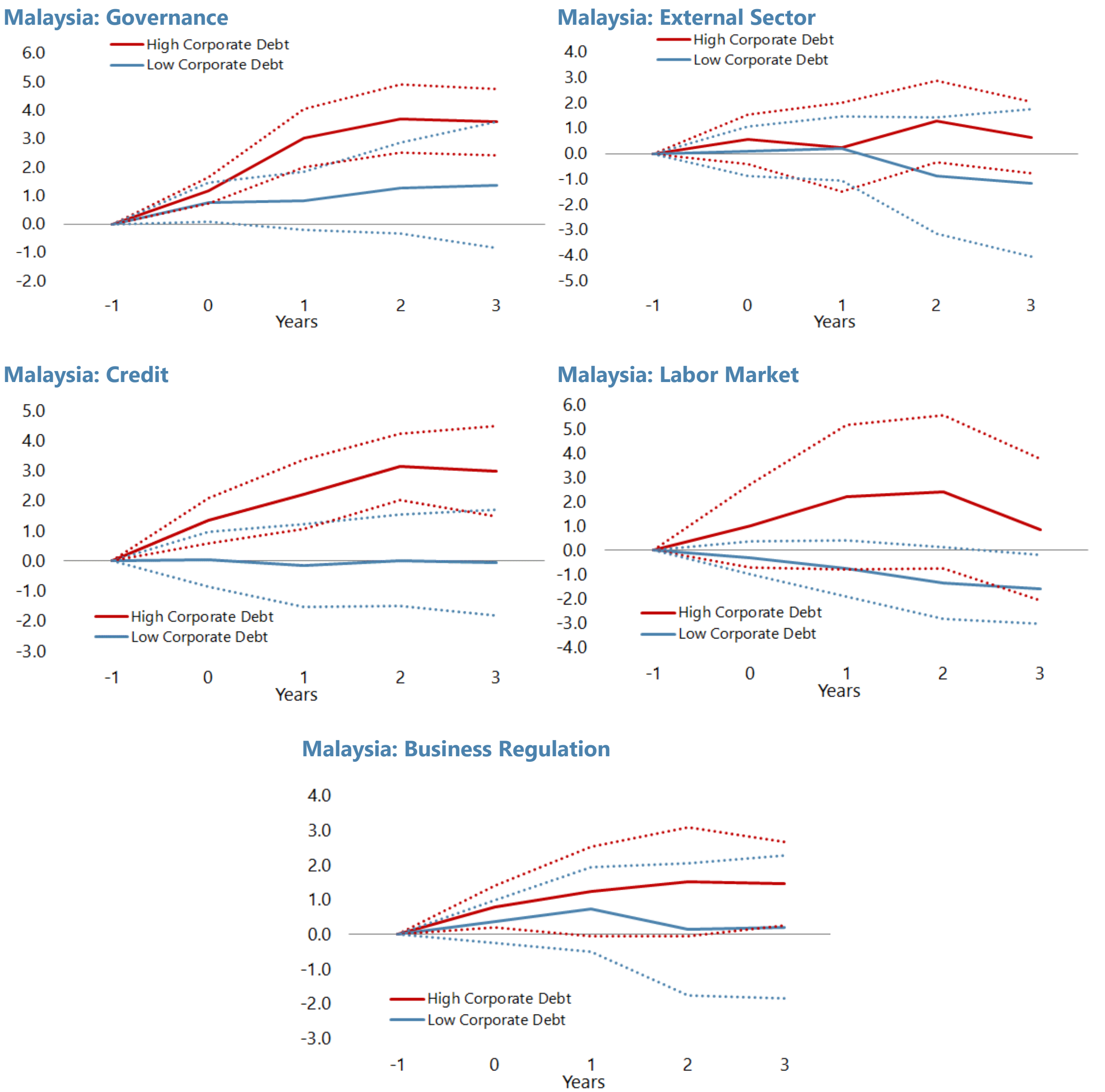
Figure 7. Malaysia: Structural Reform and Output Growth—The Role of Household Debt



Sources: World Bank, Fraser Institute, and IMF staff calculations.

Notes: 90 percent confidence interval from Kraay and Driscoll standard errors in dashed lines. Marginal Impact is in percent. t = 0 is the year of the shock.

Figure 8. Malaysia: Structural Reform and Output Growth—The Role of Corporate Debt



Sources: World Bank, Fraser Institute, and IMF staff calculations.

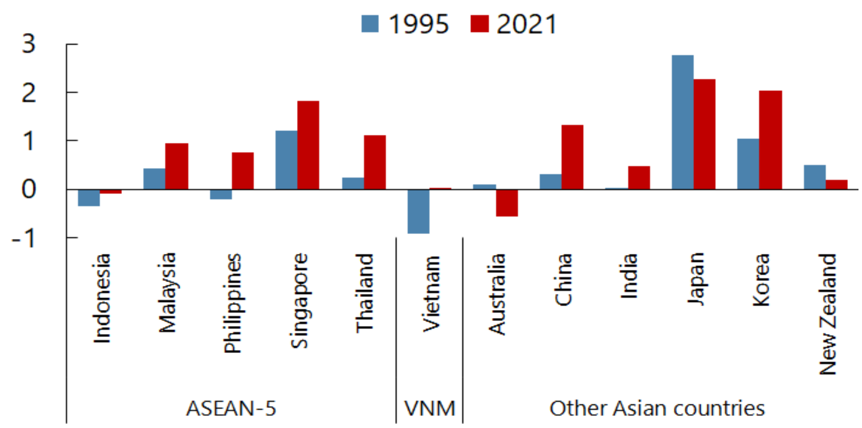
Notes: 90 percent confidence interval from Kraay and Driscoll standard errors in dashed lines. Marginal Impact is in percent. t = 0 is the year of the shock.

Malaysia: Structural Reforms and Economic Complexity

9. Despite progress, there is room to enhance economic complexity in Malaysia. (Figure 9) Economic complexity, which is a summary measure of the productive capabilities within a country, as reflected by the diversity and complexity of products it makes and exports, has improved in Malaysia over the last decades. In 2021, economic complexity has remained below ASEAN-5 peers such as Singapore and Thailand.

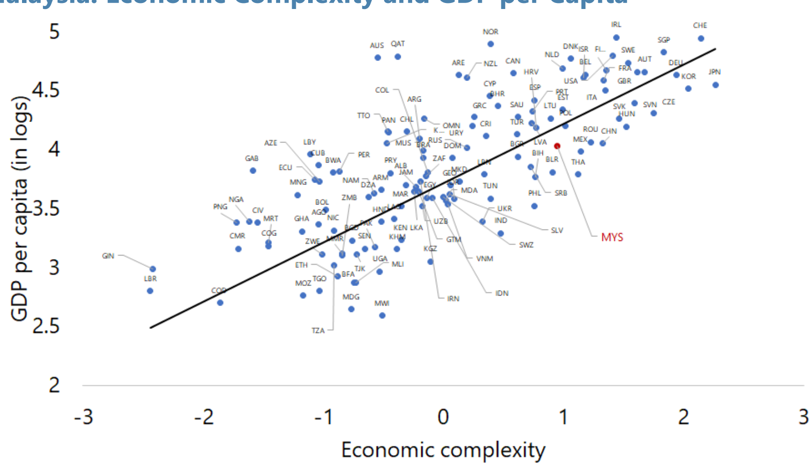
Figure 9. Malaysia: Economic Complexity Index

Malaysia: ECI by Country



Sources: Atlas of Economic Complexity (for the ECI); United Nations, Comtrade database; and IMF staff estimates. Note: ECI = economic complexity index.

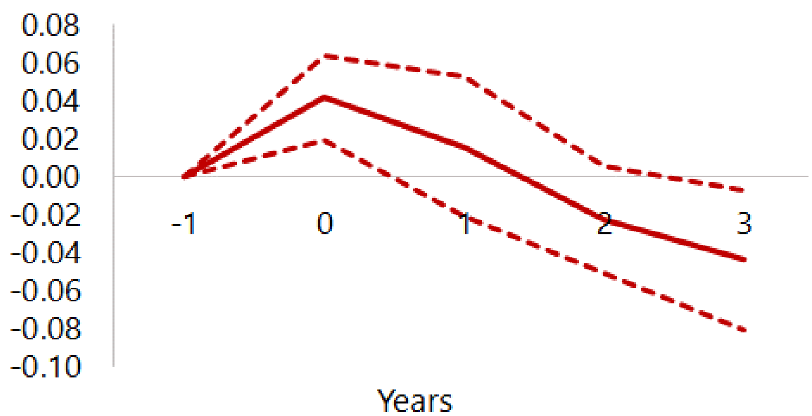
Malaysia: Economic Complexity and GDP per Capita



Sources: Atlas of Economic Complexity (for the ECI); Penn World Table 10.0; United Nations, Comtrade database; and IMF staff estimates. Note: ECI = economic complexity index.

10. We estimate the impact of structural reforms in trade and external finance (external sector) on economic complexity. Using the sample of EMs and a local projection framework similar to the one presented above (albeit without an interaction term), we investigate whether reforms in the area of trade and external finance could yield some gains in terms of economic complexity.[1] Figure 10 below shows that external sector reforms, such as trade liberalization, capital account liberalization could yield short-term gains in terms of improved economic complexity. This result is somewhat consistent with the established positive correlation between income per capita and economic complexity (see Figure 9; Hidalgo and Hausmann, 2009). Further, the liberalization of capital flow such as FDI and of trade are shown to have positive spillovers in terms of export sophistication and innovation (Krugman, 1979; Grossman and Helpman, 1991; Bustos, 2011; Javorcik et al., 2017, Bajgar and Javorcik, 2020).[2] Consistent with the literature and our finding, Jinn and Shuhaimen (2018) show that Malaysia has been successful in raising its level of complexity as a result of past structural reforms, supportive business ecosystem and greater presence of FDI.

Figure 10. Malaysia: Structural Reforms in External Sector and Economic Complexity



Sources: Atlas of Economic Complexity, Fraser Institute, and IMF staff calculations.
Notes: 90 percent confidence interval from Kraay and Driscoll standard errors in dashed lines. Marginal Impact is in unit of the Economic Complexity Index. t = 0 is the year of the shock.

Malaysia: Structural Reforms and Wage Growth

11. Given that firms are the place where wage negotiations take place, we investigate the impact of labor market and business regulations reforms on wage growth using firm level data. We use firm level data from Orbis on 16 EMs including Malaysia over the period 2000-2019, and the local projection framework to investigate the dynamic effect of structural reform on wages paid per employees. We estimate the following equation:

$$Y_{fc,t+h} - Y_{fc,t-1} = \alpha_c + \tau_t + \beta_h \, SR_{ct} + \gamma X_{ct} + \gamma Z_{fct} + \mu_f + \omega_{cs} + \varepsilon_{fct}$$

Where $Y_{fc,t+h}$, is the logarithm of wage per employee paid by firm *f*, in country *c* and in year *t*, μ_f are firm fixed effects, ω_{cs} are country-sector fixed effects. X_{ct} is a set of country level controls

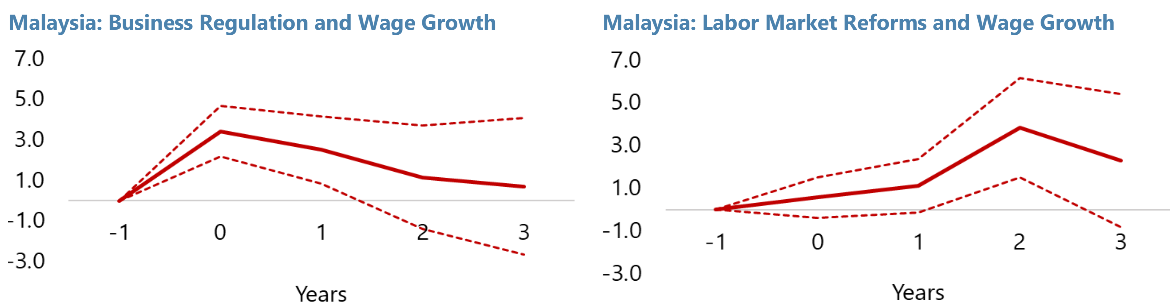
[1] We take data on Economic Complexity from the Atlas of Economic Complexity (Center for International Development, Harvard University). The economic complexity index is obtained based on the products a given country exports and the structure of its network (see Hidalgo and Hausmann, 2009).

[2] See also Appendix IV IMF country report No. 22/126 highlighting the role of trade liberalization, in particular reducing non-tariff barriers, for growth in Malaysia.

including past economic growth, output gap, and the logarithm of real GDP per capita. Z_{fct} is a set of firm level controls including lags of the dependent variable, firm age, size of assets and leverage ratio. Other variables retain the same definition.

12. Our results show that labor market and business deregulation reforms could lift wages in Malaysia (Figure 11). The findings suggest that labor market reforms toward more flexibility for both employers and employees, and market determined wage settings (wages set by companies rather than a centralized bargaining process) could lift wages up to 3.8 percent in the medium-term. Indeed, flexible labor markets, could promote wage growth by incentivizing more skill and human capital accumulation through increased job mobility (see for instance Engbom, 2022). Consistently, Orazem and Roy (2023) argue that labor market policies such as employment protection could lower the returns to human capital (lower wages) reducing per capita income by imposing a higher cost of job search, limiting worker mobility and reducing job offers rate. Further, policies that reduce the cost of job search by de-regulating labor markets could minimize firms' monopsony and induce a competition between firms and contribute to raise workers' barging power (Orazem and Roy, 2023).[3] Reducing bureaucracy costs, administrative requirements enhancing inclusion in public administration, could also benefit wage growth, raising wages by about 3.4 percent. Indeed, high barriers to firm entry in the forms of bureaucracy costs or protracted administrative processes could raise the cost of job creation (see for instance Orazem and Roy, 2023) and thus negatively affect overall wages.[4]

Figure 11. Malaysia: Structural Reforms and Wage Growth Using Firm Level Data



Sources: World Bank, Fraser Institute, and IMF staff calculations.

Notes: 90 percent confidence interval from Kraay and Driscoll standard errors in dashed lines. Marginal Impact is in percent. t = 0 is the year of the shock.

[3] Most of the literature on the impact of labor market reforms on wages focuses on advanced economies with somewhat mixed findings. For instance, Cervini-Plá et al (2014) find that the reduction in firing costs has led to wage increase in Spain. However, Van der Wiel (2010) finds the opposite results for the Netherlands and Autor et al. (2016) found no robust effect for a tightening in regulation. There is room for more work on emerging and developing countries.

[4] "Reform that reduces business burdens and increases transparency of regulatory regimes supports entrepreneurship, market entry, […] that, in turn, should produce high-paying, high quality jobs'" OECD (1997).

C. Conclusion and Policy Discussion

13. Structural reforms have the potential to boost long-term growth in Malaysia. At the current juncture with limited policy space, structural reforms would help in accelerating Malaysia's transition toward a high-income status by raising potential output. More specifically, given identified structural gaps in areas such as private debt and the size of the informal sector, output gains from structural reforms are found to be larger in Malaysia compared to the average EM.

14. Structural reforms are key to achieving the goals articulated in the MADANI Economy framework.

- Structural reforms in the external sector (more specifically reducing non-tariff barriers) could contribute to enhance economic complexity in Malaysia consistently with the New Industrial Masterplan 2030.
- Labor market reforms toward more flexibility and business de-regulation could contribute to raising wages in Malaysia, which could in turn help toward the objective to raise labor share of income and achieve a high-income status.
- Structural reforms also have the potential to increase female labor force participation and thus contribute to a more inclusive economy.
- Structural reforms could support green growth in line with the National Energy Transition Roadmap.

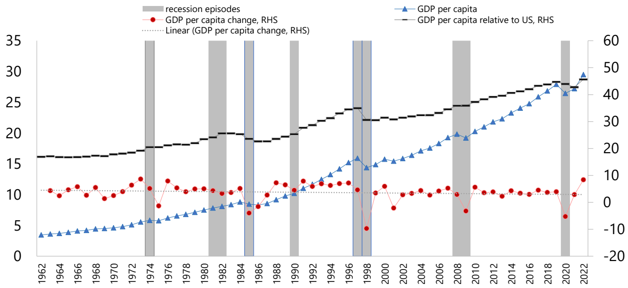
15. Packaging and sequencing of reforms could play an important role in maximizing the gains from structural reforms. Giving priority to the implementation of a package of reforms that includes governance, external sector and business deregulation has the potential to significantly accelerate output growth. This reform sequencing can also help alleviate the short-term tradeoff between promoting growth and reducing emissions as the induced growth acceleration could offset some of the short-term costs associated with climate policies and create fiscal space to engage in the green transition. A more granular approach shows that in Malaysia, strengthening good governance (control of corruption) and business regulation (reducing administrative requirements) would have strong growth impacts. Indeed, governance reforms can reduce labor market informality making subsequent labor market reforms more effective. Further, governance reforms could also boost social support for a successful fuel subsidy reform by enhancing trust in government (see Drabo, Eklou, Imam and Kpodar, 2023). Structural reforms could also contribute to increase tax revenues by raising taxable income through a larger output, a reduction in the size of the informal sector and an increase in taxable income (wages).

Annex I. Malaysia and Peers: Convergence Toward the US Over Time with Recessions

Figure 1. Malaysia and Peers: Yearly Convergence Toward the US Over Time with Recessions

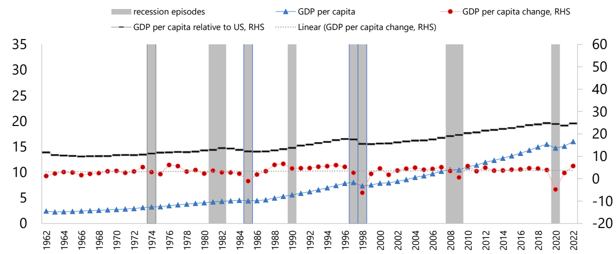
Malaysia

(in thousand PPP 2017 international dollars [lhs], in percent [rhs])



ASEAN-5

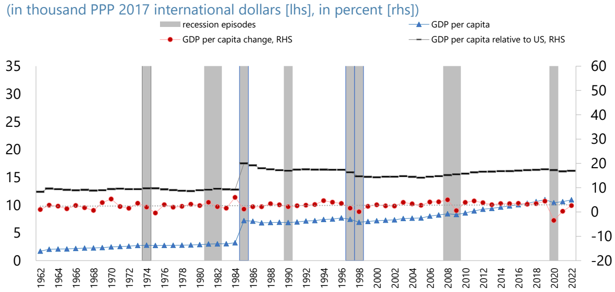
(in thousand PPP 2017 international dollars [lhs], in percent [rhs])



Note: ASEAN-5 includes Indonesia, Malaysia, Philippines, Thailand, and Vietnam.

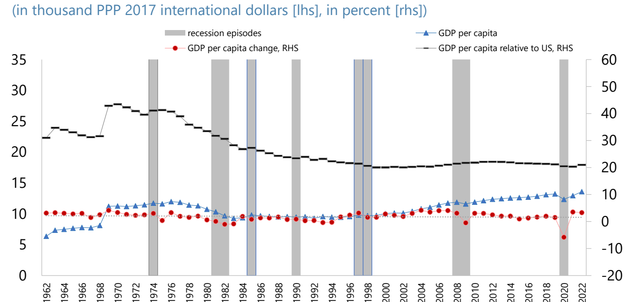
Emerging Asia

(in thousand PPP 2017 international dollars [lhs], in percent [rhs])



Emerging and Developing Economies

(in thousand PPP 2017 international dollars [lhs], in percent [rhs])



Sources: IMF WEO October 2023 and IMF staff calculations.

Note: Global recessions were taken following NBER definition and Kose et al. (2020).

Annex II. Malaysia: Description of Structural Reform Variables

This section provides a summary of structural reform data used for the empirical analysis.

1. Data used in Budina et al. (2023) to measure the structural gaps across EMDEs. Data for all categories except for two sub-indicators of green transition focus on 125 EMDEs during 2000-2020.

- **Governance:** The Worldwide Governance Indicators (WGIs) is a database which reports aggregate and individual governance indicators over the period 1996-2021. These indicators summarize the views of various counterparts, from citizens to enterprises and expert survey respondents. Governance is computed as the simple average of the six individual WGIs. :(i) voice and accountability, which aims at measuring the citizens' perception of government transparency in a given country (i.e., elections, freedom of speech); (ii) political stability and absence of violence/terrorism, which measures the likelihood of politically-induced violence; (iii) government effectiveness, which measures the quality of public services, policy formulation and implementation, as well as the degree of independence from political pressures; (iv) regulatory quality, which captures the ability of governments to formulate and implement regulations that can promote private sector development; (v) rule of law, which captures the extent to which market participants feel confidence in the protection of property rights, the quality of contract enforcements, and the police force; and (vi) control of corruption, which aims at capturing perceptions on the level of corruption in a given country.

- **External Sector:** The Fraser Institute's Economic Freedom of the World database compiles data to measure economic freedom. It includes over 40 variables and evaluates a country's ability to exchange goods, services, and ideas. Each component of the index is originally placed on a scale from 0 to 10 that reflects the distribution of the underlying data. The degree of economic freedom in Trade and External Finance was re-defined to exclude variables associated with the World Bank's Doing Business project as it has been discontinued The indicator is obtained as the simple average of four main components: (i) tariffs, which aim to measure to what extent tariffs can be a barrier to trade freely internationally (tariff revenues, tariff rate and volatility of tariffs); (ii) non-tariff trade barriers; (iii) black-market exchange rate, which aims at capturing the disparity between the official and the parallel (black-market) exchange rate; and (iv) control of the movement of capital and people, which encompasses a country's degree of financial openness, restrictions to visitors, and whether capital controls are in place. Indicators are rescaled to a range of 0 to 1, where higher values indicate greater economic freedom.

- **Credit Market Regulation:** The Fraser Institute's Economic Freedom of the World database aims at measuring the degree to which regulation can interfere with the freedom of engaging in domestic credit markets. The aggregate indicator is composed of three individual concepts: (i) private ownership of banks, which looks at the extent to which bank deposits are held in privately owned institutions; (ii) private sector credit, which measures the relationship between government and private borrowing; and (iii) interest rate controls, where countries in which interest rates are determined by the market and have stable monetary policy are deemed to have a higher degree of economic freedom. The aggregate and individual indicators were rescaled on a scale from 0 to 1, where a higher value implies a higher degree of economic freedom.

- **Labor Market Regulation:** Data is part of Fraser Institute's Economic Freedom of the World database. There are several types of regulation that can hinder the economic freedom of both employers and employees, such as minimum wage laws, unionization, and dismissal regulation. The labor market component is designed to measure the extent to which these restraints upon economic freedom are present. The aggregate and individual indicators were rescaled on a scale from 0 to 1, where a higher value implies a higher degree of economic freedom.

- **Business Regulation:** Data is part of Fraser Institute's Economic Freedom of the World database. This indicator aims at measuring the regulations and bureaucratic processes in each country that can undermine economic freedom by restricting entry and decreasing competition. The business regulation indicator was redefined to exclude variables associated with the World Bank's Doing Business project as it has been discontinued. The indicator is the simple average of three main components. The aggregate and individual indicators were rescaled on a scale from 0 to 1, where a higher value implies a higher degree of economic freedom.

- **Green transition**: Data in this category comes from (i) Climate Policy Stringency, (ii) Environmental Tax, and (iii) Energy Efficiency and Renewable Energy Policy Frameworks. (i) Green measures, from the 'Climate Policy Database', are a combination of policies with an explicit climate change mitigation objective, such as greenhouse gas emissions reduction strategies; energy policies, that help to decarbonize the energy supply and/or reduce energy demand; and policies that aim to introduce low-emissions practices and technologies to non-energy sectors, such as agriculture and land use. In this analysis, climate policy stringency in each country is proxied by the number of climate mitigation instruments in place in each year. (ii) Environmental tax: Consistent with the literature (see Dogan et al., 2022), the environmental tax revenues to GDP ratio is used as the proxy for the effective environmental tax rate. The dataset is obtained from the IMF Climate Change Indicators Dashboard focusing on 73 EMDEs covering the period 2000-2020. (iii) Energy efficiency standards and renewable energy frameworks were obtained from the World Bank's Regulatory Indicators for Sustainable Energy (RISE) database. RISE is a set of indicators aimed at gaining a better understanding of existing policy and regulation in sustainable energy across countries. This SDN focuses on 101 EMDEs covering the time period 2010-2020.

2. Data that are used to investigate how key structural characteristics of Malaysia could affect potential gains from structural reforms.

- **Household debt.** IMF's Global Debt database covers 44 EMDEs for household debt measured by debt, loans, and debt securities in percent of GDP. The data covers the period 2000-2020.

- **Corporate debt.** We take IMF's Global Debt database's nonfinancial corporate debt, loans, and debt securities in percent of GDP for corporate debt. The database covers 48 EMDEs and we took data over the period 2000-2020.

- **Atlas of Economic Complexity.** Harvard Growth Lab's Country Rankings assess the current state of a country's productive knowledge, through the Economic Complexity Index (ECI). Countries improve their ECI by increasing the number and complexity of the products they successfully export. The higher the value of the indicator, the higher is the complexity of the products it exports.

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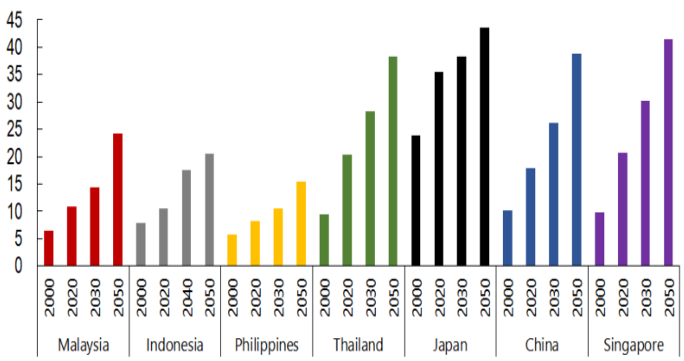
Appendix VIII. Towards Working and Retirement Income Security for Malaysia's Aging Society[1]

Over the last few decades, Malaysia has successfully moved from an agrarian low-income to an upper middle-income economy. Its labor force however has not sufficiently reaped the benefits of industrialization. Malaysia's workers have long been paid low wages, and while there is almost no gender pay gap, a wide skills-pay-gap has prevailed. Malaysia's population is rapidly ageing amid serious concerns about retirement income security recently exacerbated by sizeable, allowed pension fund withdrawals during the pandemic. While these interrelated issues have been pertinent and well recognized, decisive policy actions have been missing. This appendix outlines the problem and discusses potential remedies. Achieving progress on these fronts is crucial for Malaysia's long-term aspiration of becoming a high-income nation.

A. Rapidly Aging Population

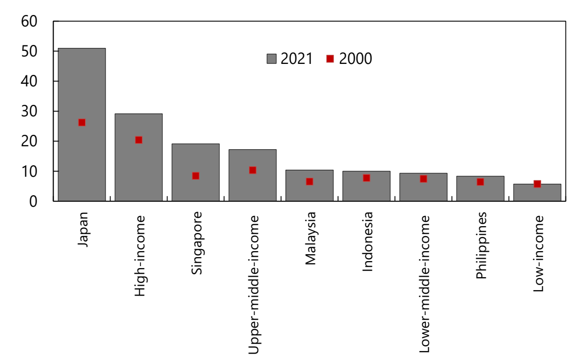
1. Malaysia's population is experiencing a major change in its age structure: Malaysians are living longer (with life expectancy at birth increasing by 5 years to 77.6 years in 2030 compared to 2000 and further to 80.8 by 2050), and the fertility rate has fast declined (from 3 children born per woman in 2000 to 1.7 in 2030). This has progressively increased the share of elderly Malaysians aged 60 and over, which is projected to increase to 14 percent by 2030 and to reach 24 percent by 2050, a four-fold increase since 2000. In levels, ageing in Malaysia exceeds that of neighboring Indonesia and Philippines, and the growth rate of elderly population over the last 5 decades in Malaysia has been at par with that in Japan and Singapore. Malaysia's old age dependency ratio stands at 10.4 percent and has increased the most during 2000-2021 compared to its peers.

Malaysia: Elderly Aged 60 and Over
(percent of total population)



Source: UN Population Division. World Population Prospects: The 2022 Revision.

Malaysia: Old Age Dependency Ratio
(in percent; number of people older than 64 relative to number in working age population (15-64))



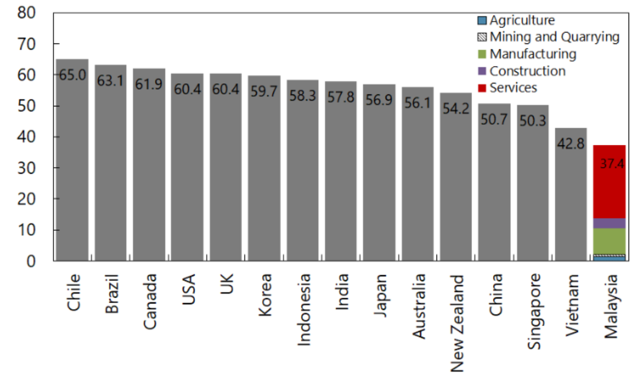
Sources: United Nations, World Population Prospects (2022)

[1] Prepared by Ghada Fayad.

B. Low Pay

2. Malaysia's labor share of income is low. It increased from 31.7 percent in 2010 to 35.6 in 2016 but has since remained stagnant or declined reaching 32.4 percent in 2022. Compared to advanced economies and peers, Malaysia's labor share ranked the lowest in 2020, with the services sector receiving over 60 percent of labor's share in income. The low labor share in income cannot be explained by capital intensity, as most industries in Malaysia remain labor-intensive. Moreover, the expansion of that share over 2010–2016 was driven by the reallocation of economic activity into relatively more labor-intensive and lower-paid sectors rather than gains in labor income share within each sector (BNM, 2018).

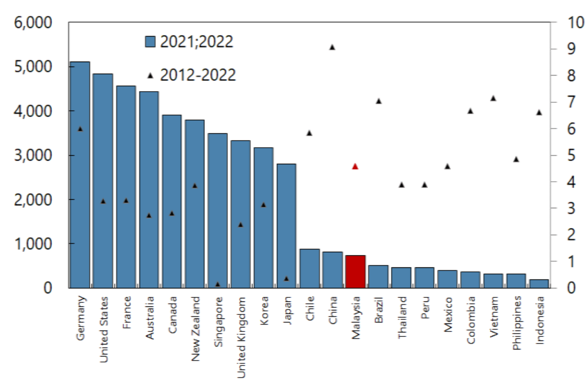
Malaysia: Labor Share in Income, 2020
(Compensation of employees in percent of GDP)



Sources: Department of Statistics Malaysia, ILO, and IMF staff calculations.

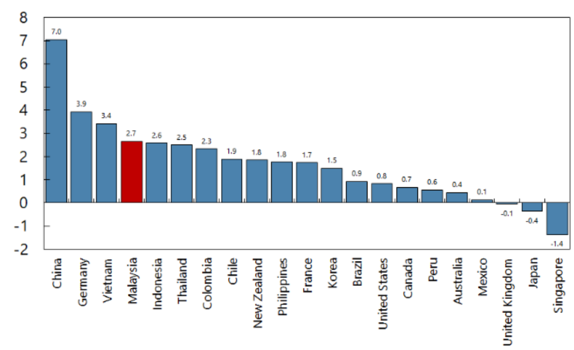
3. Average nominal wages in Malaysia have been indiscriminately low, significantly lower than wages in advanced economies, and slightly higher than those in Asian and other EM peers.

Malaysia: Nominal Wage Level and Growth Across Countries
(LHS: USD latest available; RHS: compound annual average growth)



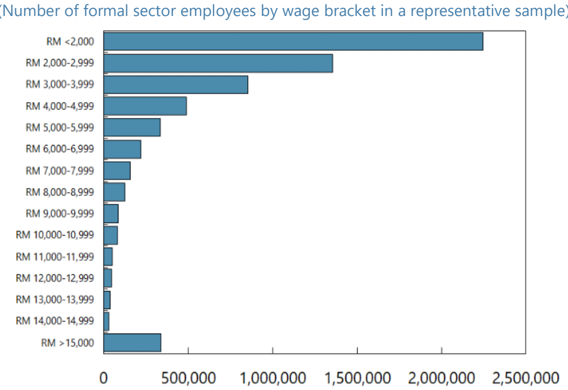
Sources: Department of Statistics Malaysia, ILO, and IMF staff calculations.

Malaysia: Average Real Wage Growth Across Countries
(Compound average annual growth rate in percent, 2012–2022)



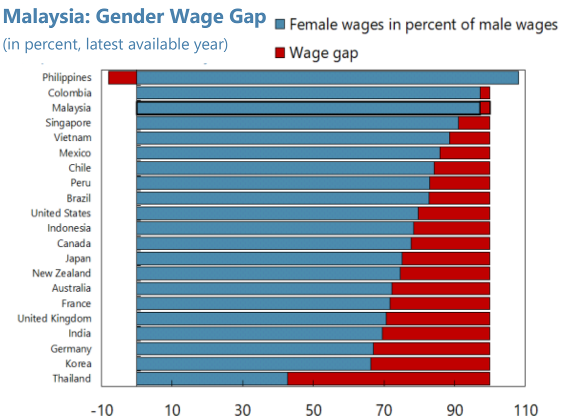
Sources: Department of Statistics Malaysia, WEO, ILO, and IMF staff calculations.

Malaysia: Wage Distribution by Wage Bracket
(Number of formal sector employees by wage bracket in a representative sample)



Sources: Department of Statistics Malaysia

Malaysia: Gender Wage Gap
(in percent, latest available year)

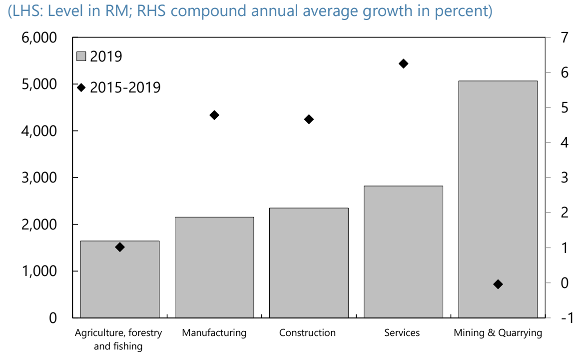


Sources: Department of Statistics Malaysia, ILO, and IMF staff calculations.

Over the last decade, wage growth in Malaysia, at about 4.6 percent, lagged wage growth in peers. In real terms, wages grew by 2.7 percent over the last decade, faster than high income countries as expected, and also than ASEAN peers except for Vietnam. Malaysia's low pay incidence (percentage of the workforce earning less than two thirds of the median wage) is estimated at over 30 percent, significantly higher than the OECD's 14 percent. By gender, Malaysia's wage gap is among the lowest in the world, below that of many advanced economies, with female wages at 97 percent of male wages overall. In other words, low pay does not discriminate between gender in Malaysia.

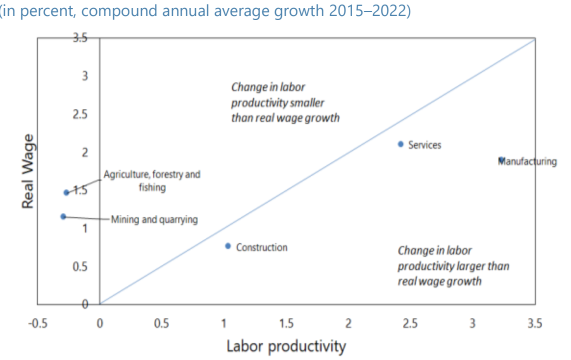
4. Wages and productivity have not moved in tandem. By industry, and up until the pandemic, the sectors that have grown the most in real terms (services and manufacturing), which together account for over 80 percent of real output and of national employment, suffer from low pay. Over the last decade or so, real wage growth exceeded productivity growth (real output per employment) in the agriculture and mining sectors, two sectors with stagnant productivity growth. For services and construction, productivity and real wage growth were broadly similar, on average. On the other hand, labor productivity gains in the manufacturing sector were faster than real labor earnings growth. When productivity is measured per hours worked instead, construction and services join the manufacturing sector below the 45-degree line, with productivity gains exceeding real earnings.

Malaysia: Real Wages and Growth by Industry
(LHS: Level in RM; RHS compound annual average growth in percent)



Sources: Department of Statistics Malaysia, WEO, and IMF staff calculations.

Malaysia: Changes in Labor Productivity and Real Wages by Industry
(in percent, compound annual average growth 2015–2022)

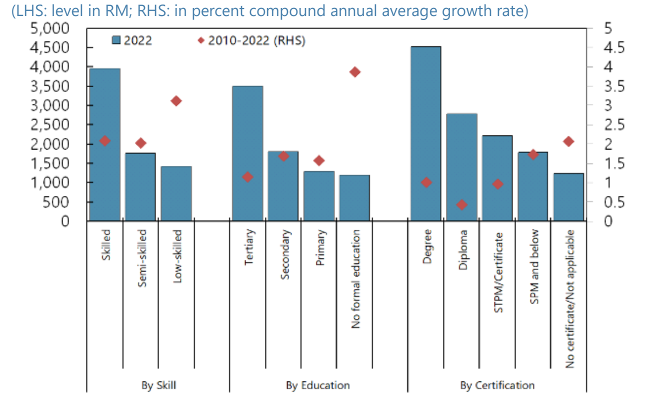


Sources: Department of Statistics Malaysia, WEO, and IMF staff calculations.

5. By qualification, whether measured by skill level, education or degree of certification, a large gap exists between the highest and lowest or mid-qualified. This is despite high wage growth for the lowest qualified over the last decade, driven in part by the introduction of minimum wages in 2013. Those in the middle (i.e. semi-skilled) have experienced the slowest real wage growth and their incomes are more comparable to the lower than the higher spectrum (and closer to minimum wage levels). High-skilled workers have instead faced stagnant wage growth. In the last five years, skilled job creation decreased by 24 percent while that for the semi and low skilled increased. At the same time, the percent of the labor force with tertiary education has been steadily increasing to reach 34.5 percent in 2022. The apparent lack of job creation for the highly skilled has resulted in skill-related underemployment which measures those with tertiary education and working in the category of semi-skilled and low-skilled jobs. In 2022, skill-related underemployment has been on an increasing trend to reach close to 2 million persons, a staggering 38 percent of total employed workers with tertiary education.

Malaysia: Average Real Wage Levels and Growth by Qualification

(LHS: level in RM; RHS: in percent compound annual average growth rate)



Sources: Department of Statistics Malaysia, WEO, and IMF staff calculations.

6. If left unaddressed, the narrowing income premium for education can lead to lower incentives to pursue higher education. It could also lead to outward skilled migration, exacerbating the brain drain issue. Among other visible outcomes are more workers choosing to be self-employed. By December 2022, there were about 2.8 million own-account workers in Malaysia, accounting for 18 percent of total formal employment. Workers have also dropped out of the labor force: between 2011 and 2021 the informal sector in Malaysia grew by 30 percent to reach a total of 1.3 million workers, 72 percent of which are own-account workers. An increasing share of those are skilled individuals: in the last decade, the share of informal workers with tertiary education increased from 9 to 16 percent. In the same vein, while the most common qualification in the informal sector was SPM or below, the rise in number of degree-holders is notable.

C. Pre-pandemic Pension Inadequacy Exacerbated by Massive Pandemic Withdrawals[2]

7. Provident funds, like Malaysia's Employee Provident Fund, have been the dominant form of retirement provision in Asia. EPF is the world's 14th largest pension fund with about USD 228 billion assets under management. The attractiveness of provident funds is related to countries' structural characteristics such as revenue weaknesses and lack of social safety systems, two characteristics observed in Malaysia. More specifically, provident fund savings can be used to advance national development objectives, rather than relying on budget revenues, and they can serve a wide range of workers' savings needs beyond the need to save for retirement, for instance for financing health, education, or housing needs (Jackson and Inglis, 2021). However, this policy design feature of non-retirement savings that could be withdrawn, exacerbated by additional pandemic-related allowed withdrawals, coupled with low wages for contributing members, increasing share of the gig economy, and the ageing population, have raised serious concerns about the adequacy of retirement benefits in Malaysia.

8. EPF coverage remains low. It served 15.72 million members as of end-2022, out of which 8.39 million were active members, representing 50 percent of Malaysia's labor force. Malaysia's

[2] This section focuses on Malaysia's Employee Provident Fund (EPF), a fully funded, government-managed, defined contribution pension system for private sector workers with standard employment contracts.

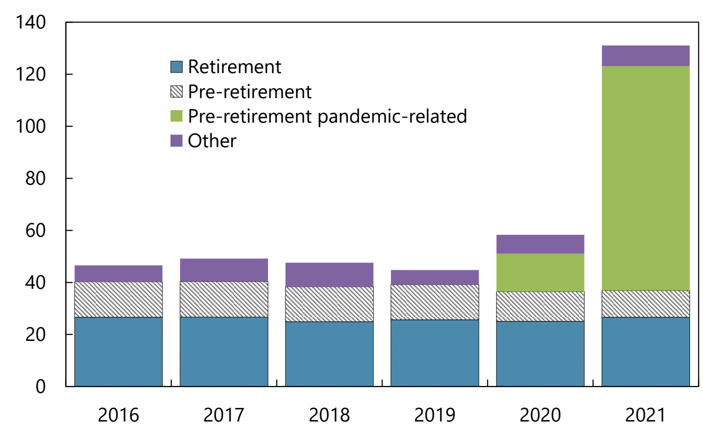
informal workers, estimated at about 3.5 million in 2021, or about 23 percent of the country's total employment, are not mandated to contribute to the EPF but can elect to do so.

9. **Retirement age at 60 is low, and withdrawals are in lump-sum payments,** which offers no protection against inflation nor longevity risks. While the OECD average normal retirement age was equal to 64.2 years for men and 63.4 years for women in 2020, retirement ages in some Asian economies are above 60, such as in Hong Kong SAR, the Philippines and Singapore. Moreover, retirement savings can be withdrawn at age 55.

10. **Notwithstanding good contribution rates, low wages inhibited high contributions, not all of which are earmarked for retirement.** In 2019, the EPF contribution rate was 24 percent for wages up to RM 5,000 per month for members under age 60, with employees contributing 11 percent and employers contributing 13 percent. For wages above RM5,000, the contribution rate is 23 percent. These rates have been lowered during the pandemic, then increased, currently standing at 22 and 21 percent respectively. EPF consists of two accounts: Account I, which is earmarked for retirement (at age 55), receives 70 percent of total contributions, while Account II, which can be accessed prior to retirement for specified purposes, noted above, receives 30 percent. It is argued that Malaysia's structurally low wages, coupled with high household debt, have inhibited formal sector workers' ability to effectively contribute to EPF, despite good contribution rates.

11. **Pandemic-related withdrawals exacerbated members' insufficient savings problem.** In addition to the conditional pre-retirement withdrawals, further withdrawals were allowed during the pandemic years (2020-2022) under various schemes, totaling a staggering RM145 billion (US$32 billion) during that period. As a result, EPF recorded in 2021 first ever negative net contribution (contributions after withdrawals) in 20 years of RM58.20 billion. More worrying is the impact on retirement savings adequacy, with median savings of EPF accounts for all members below age 55 dropping from RM19,111 in 2019 to RM9178in 2022. The trend is particularly significant for the EPF B40 group below 55, where median savings per member stood at about RM842 ($186) as of end 2022.

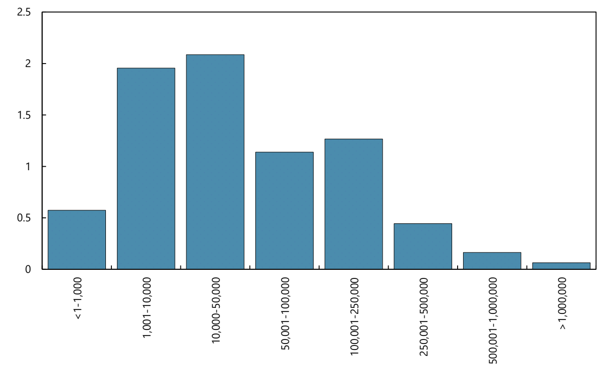
Malaysia: EPF Withdrawals
(in billion RM)



Sources: EPF Annual Report 2021.

12. Most EPF members do not meet its basic savings threshold. At EPF, basic savings refer to the minimum amount of savings in Account I that a member should have upon reaching age 55. This benchmark is used by EPF to gauge the adequacy of retirement income. As of January 2019, basic savings threshold has been set at RM240,000, which is equivalent to a monthly retirement income of RM1,000 over a 20-year retirement period, below the poverty line and minimum wages. As of end October 2023y, only about 19 percent of EPF members aged 18-55, and 39 percent of active formal sector members aged 51-55, met basic savings. Looking at active EPF members, about a third had savings up to RM10,000 or about USD2100, and only 9 percent with savings above RM250,000, as of end-2021.

Malaysia: Active EPF Member Savings' Range
(in millions)



Sources: EPF Annual Report 2021.

D. Policy Initiatives and Recommendations to Address Low Incomes

13. The MADANI Economic Framework has set as one of its medium-term targets increasing the labor share of income to 45 percent. It remains critical how this target is achieved.

- **Further lifting wages of low-skilled workers.** The minimum wage system was introduced in 2013 at RM1,200 (US$273), and was increased to RM1,500 (US$341) in May 2022. Beyond ensuring enforcement, periodic reviews of the minimum wage (as done in Malaysia every two years) should ensure the adequacy of the minimum wage, including through its comparison to the poverty line and indicators of living wages.

  Linking wages and productivity: Adoption of Malaysia's existing productivity-linked wage system (PLWS), a flexible and competitive wage system that establishes a closer link between wages and productivity/performance, has been low, hampered by lack of legislative power, and low transparency from employers. A voluntary- and incentives-based Progressive Wage Policy (PWP) was approved in cabinet in August, 2023. Since then, a white paper was presented in parliament in November, outlining the underlying features and timeline for the implementation of the PWP. This includes engagement sessions with stakeholders and preparation for a pilot project in the first half of 2024, to be implemented in Q3. The PWP is targeted towards SMEs and wages in the range of RM1500–4999, both in terms of starting levels and growth. With budget support providing employers incentives to join in inception years, those participating in the PWP are expected to provide training that would increase employees' productivity and in turn their wages. Beyond the PWP, the link between productivity and wages could be enhanced through closer collaboration between the National Productivity Council and the National Wage Consultative Council, with the mandate to strengthen the link between productivity and wages in Malaysia, in both level and growth terms (BNM, 2018).

- **Generating higher demand for quality labor through the creation of high-skilled jobs.** For this, high-quality domestic and foreign investments are needed, and across all sectors. Several budgets have recognized the importance of investment incentives. The 2024 Budget announcement of a tiered results-based system which incentivizes investors based on their value-added contributions is very timely as it is meant to stimulate companies toward investment in high-growth and high-value areas.

E. Policy Initiatives and Recommendations to Address Retirement Insecurity

14. While addressing low wages can go a long way in improving retirement income security, complementary shorter-term policies to boost retirement savings accumulation are urgently needed. These include lengthening the savings' accumulation period by allowing retirement withdrawals only at retirement age (rather than at 55 currently), ringfencing and reinvesting a portion of savings that would otherwise have been withdrawn, and eventually gradually increasing retirement age along with life expectancy. They also include improving savings by increasing the share of contributions dedicated to retirement/Account I and improving coverage by ensuring universal registration. Policies should also simultaneously focus on improving old-age safety net and providing employment opportunities for the older cohort.

15. The EPF has been focusing on improving adequacy, coverage, and sustainable returns, to help rebuild members' savings, with support from recent Budgets. First, EPF is seeking to get more members to contribute voluntarily via the EPF's voluntary contribution and voluntary excess programs. In 2018, the EPF introduced the i-Saraan initiative for self-employed members without fixed incomes and employees of the gig economy to save for retirement through EPF contributions. Recent Budgets have provided incentives to do so: in the 2022 Budget, the government announced that will match a minimum of 15 percent from the voluntary contributions and expanded the beneficiaries of this initiative to include those aged between 55 and 60 years. The 2023 Budget raised the EPF voluntary contribution limit from RM60,000 to RM100,000 per year, and the i-Saraan was extended and improved by raising the matching contribution ceiling from RM250 to RM300. For members aged between 40 to 54 years old with EPF savings of less than RM10,000, the 2023 re-tabled Budget agreed to contribute an additional RM500 to their EPF Account 1 savings, with a total allocation of about RM1 billion. The 2024 Budget increased the limit of the government incentive under the EPF's i-Saraan program to RM500 per year, limited to RM5,000 for life. The government also announced that the accounts of EPF members will be restructured to boost retirement savings and help members balance short, medium, and long-term needs, with a new EPF Flexible Account introduced and accessible to members at any time especially in times of emergency. Second, the EPF has been working towards establishing a more pension-like approach towards providing members with a more stable income in their post-retirement years, through current encouragement to members to voluntarily shift to regular monthly payout rather than lump-sum withdrawals.

16. Notwithstanding these initiatives, more substantive policy intervention is needed as retirement security should be at the top of policy priorities. Below are some additional proposals to widen coverage and increase savings:

- **Universal registration into social insurance: social security arrangements and data depend** on formal employer-employee relationships, leaving the large and growing segment of informal workers in Malaysia uncaptured. As a start, BNM (2022) proposes automatic registration of all 18-year-olds into EPF databases as a potential option. This is in line with the government's current pursuit of building a harmonized social protection database. In 2021, Phase One of the Social Protection Database (PDPS) containing data all social and economic assistance provided to vulnerable groups was launched.
- **Lengthening the accumulation phase.** First and foremost, this can be done by allowing withdrawals only at retirement age (rather than at 55 currently). Furthermore, ringfencing and reinvestment can help. Currently in Malaysia, as of 2017, any incremental contributions made by workers who remain employed past retirement age must be preserved until age 60. While this is a step in the right direction, reinvesting a portion of savings that would otherwise have been withdrawn upon the withdrawal age, thereby extending the accumulation period, is needed (BNM, 2022). For example, in Singapore, a portion of an individual's savings at age of 55 are transferred to their retirement savings account, allowing it to grow for a further 10 years. Finally, eventually gradually increasing the retirement age in line with increased life expectancy can help make sure that retirees do not outlive their savings.
- **Increasing share of contributions dedicated to retirement/Account I**: Thus far only 70 percent of savings is dedicated to Account I and thus preserved for retirement. This share can increase further to ensure retirement income security. In that respect, the planned restructuring of EPF accounts is meant to increase that share to 75 percent, and thus is a step in the right direction. Overall, as argued in Jackson and Inglis (2021), the share of total provident fund savings preserved for retirement should be determined by informed policy decisions, and not left as a residual after non-retirement withdrawals are accounted for. In the future, contribution rates can also be raised once meaningful increases in wages are achieved.

The reforms should be accompanied by

- **Creating job opportunities for old-age workers seeking to re-enter the labor force**. The labor force participation rate for individuals aged 60 to 64 has been low, averaging below 40 percent over the last two decade, and stood at just 36 percent in 2022. Policies should therefore prioritize resolving market failures preventing old-age persons interested to join the labor force from obtaining suitable employment. Measures such as hiring incentives for old-age workers can be pursued.
- **Strengthening old-age safety net**. The Bantuan Orang Tua (BOT) program offers basic cash transfers old-age poverty protection in the form of means-tested, noncontributory social pensions. However, its coverage and adequacy have been low. Adequacy should be

enhanced by ensuring that cash assistances are linked to standard of living measures. Enhancing sufficiency of elderly assistance could also lead to indirect benefits for current workers. This is because greater public assistance would reduce the reliance on subsistence support from their families or children, enabling them to build their own savings buffers.

F. Conclusions

17. It is critical for workers in Malaysia to receive adequate compensations for their contributions to national income and adequate retirement benefits for their old age. This is more important as the population is ageing, and the country is getting closer to achieve high-income status. A labor force in which welfare is preserved and enhanced will be incentivized to raise productivity, achieve greater value creation, and speed up the transition to the next phase. It will also be more endowed to make meaningful contributions to retirement savings. While low pay has recently received more attention in the policy dialogue and initiatives with increasing labor share of income as a medium-term target, concrete policy plans for pension reform have lagged, despite ongoing public calls to address retirement insecurity. The current administration's focus on structural reforms provides the right time to address another existing gap and improve Malaysians' wellbeing.

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Appendix IX. Impact of AI Technologies on Malaysia's Labor Market[1]

Advancements in AI technologies are poised to transform labor markets across the world. Using estimates of occupational exposure to AI, this study finds that a sizeable share of Malaysia's labor market, particularly workers in professional, managerial, and clerical support roles, is exposed to AI. Training, upskilling and public AI awareness programs have the potential of mitigating the risks of AI, while reaping its potential benefits.

1. Rapid advancements in AI technologies are expected to transform the economic landscape, particularly by reshaping the nature of work. Although AI has the potential to enhance labor productivity as a support tool, it also poses risk of labor displacement due to task automation. To better prepare for the impact of AI on labor markets, it is essential to study the occupations that are most exposed to AI, so that policies can be designed not only to mitigate its impact on labor displacement, but also to harness the benefits of AI as a support tool.

2. A micro approach that links applications of AI to workplace abilities can be used to study the exposure of occupations to AI. O*NET, a database developed by the US Department of Labor, decomposes occupations (up to 8-digit level based on the Standard Occupational Classification (SOC) system) into 52 workplace abilities covering cognitive, physical, psychomotor, and sensory abilities. Felten et al. (2021)[2] consider a set of 10 AI application (for example, abstract strategy games, image recognition, speech recognition) and link them to the workplace abilities using survey data to estimate ability-level AI exposure. This ability-level AI exposure, combined with weights for the prevalence and importance of the abilities in each occupation, can be used to calculate the exposure of each occupation to AI. This is referred to as AI occupational exposure (AIOE).

3. Estimates suggest that while professionals are most exposed to AI, workers in elementary occupations are least exposed, although there is significant dispersion within occupations. Mapping AIOE estimates by Felten et al. (2021), which are classified based on the SOC system, to the ILO International Standard Classification of Occupations (ISCO-08), and standardizing the scores, we estimate AIOE based on Malaysia's occupations classifications. Based on average AIOE scores within an occupational category, the results suggest that professionals, managers, clerical support workers, and technician and associate professionals are more exposed to AI, relative to workers in occupations that require a higher degree of physical effort and exertion, such as elementary occupations, skilled agriculture and forestry, crafts and related trades, and plant, machine operators, and assemblers. There is, however, a significant variation of AIOE within each occupation. For instance, while the AIOE for workers in services and sales is relatively low on average, the dispersion within this occupational category is very high, as a fire-fighter is a lot less exposed to AI than a tele-marketer, even though both are in the services and sales occupation.

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[1] Prepared by Shujaat Khan.

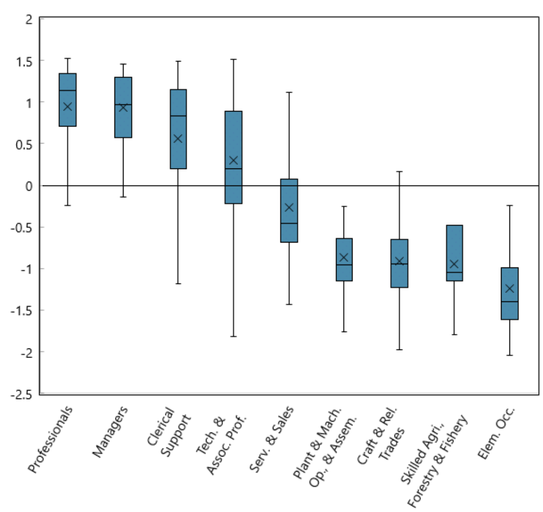
[2] Felten, Edward, Manav Raj, and Robert Seamans, 2023. Occupational, industry, and geographic exposure to artificial intelligence: A novel dataset and its potential uses. *Strategic Management Journal*, 42(12), pages 2195–2217.

4. A significant share of Malaysia's labor force stands exposed to AI. Using the average AIOE score within each occupational category and classifying occupations with a positive standardized score as occupations with "high" exposure, staff estimates suggest that about 39 percent of Malaysia's occupations have a high exposure to AI. Occupations with a positive AIOE score, ranked by their employment share, are professionals, clerical support workers, technician and associate professional, and managers.

5. While AI has the potential to displace certain roles, it also has the potential to complement the tasks in some occupations. A recent study by Pizzinelli et al. (2023)[3] extends the measures of AI exposure to distinguish between AI's potential to complement or substitute for labor. They find that high-skill occupations, despite being highly exposed to AI, can also benefit from AI's complementary role in those occupations, while low-skill occupations with a high exposure to AI risk being substituted by AI. For instance, they estimate that while lawyers and judges might benefit from AI as a support tool, leading to productivity enhancements, a telemarketer, despite having a similar AI exposure level as lawyers, may be substituted by AI due to limited complementarity.

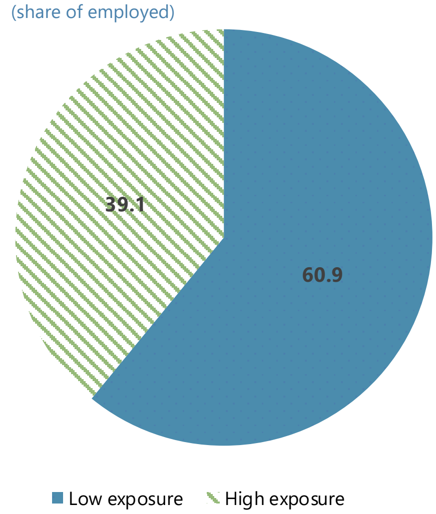
6. It is essential to take a proactive approach to formulating policies that mitigate the risks of AI, while harnessing its potential benefits. Training, upskilling and public AI awareness programs, particularly for occupations that are most exposed to AI, can increase worker productivity and mitigate the risk of displacement by AI. As AI technologies evolve in their abilities, policymakers need to continuously assess the sectors that are most exposed to AI and design policies to effectively transition the human resource.

Malaysia: AI Occupational Exposure



Source: Felten et al. (2021) and IMF staff calculations.

Malaysia: AI Occupational Exposure
(share of employed)



Source: IMF staff calculations.

[3] Pizzinelli, Carlo, Augustus J. Panton, Marina Medes Tavares, Mauro Cazzaniga, and Longji Li, 2023. Labor Market Exposure to AI: Cross-country Differences and Distributional Implications. IMF Working Paper No. 2023/216.

MALAYSIA

February 2, 2024

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

Asia and Pacific Department

CONTENTS

FUND RELATIONS

(As of January 31, 2024)

Membership Status: Joined March 7, 1958; Article VIII

General Resources Account

	SDR Millions	Percent of Quota
Quota	3,633.80	100.00
Fund holdings of currency (exchange rate)	2,622.11	72.16
Reserve tranche position	1,011.72	27.84
Lending to the Fund New Arrangement to Borrow	0.71	

SDR Department

	SDR Millions	Percent of Allocation
Net cumulative allocation	4,828.98	100.00
Holdings	4,328.54	89.64

Exchange Arrangement:

The de jure and de facto exchange rate arrangements are floating.

Malaysia maintains bilateral payments arrangements with 7 countries. The authorities have indicated that these arrangements do not have restrictive features.

The current foreign exchange policy (FEP) rules include prudential measures to promote monetary and financial stability while safeguarding the balance of payments position and value of the ringgit. The 2019 and 2020 Article IV Consultation Reports (IMF Country Reports No. 19/71 and No 20/57) list exchange rate measures that have been taken between December 2016 and December 2019.

In April 2021, the BNM announced further liberalization of the FEP policy aimed to improve business efficiency and provide flexibility for corporates in particular export-oriented industries to better manage their foreign exchange risk exposure.

The Malaysian authorities view remaining FEP rules as prudential in nature and necessary to ensure the availability of adequate information on the settlement of payments and receipts as part of the monitoring mechanism on capital flows. These controls do not contravene Malaysia's obligations under Article VIII. Malaysia has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains a system free of restrictions on the making of payments and transfers for current international transactions except for restrictions in place for security reasons notified to the Fund pursuant to Decision No. 144-(52/51).

Malaysia, in accordance with the UN Security Council resolutions implements the freezing without delay of funds and other financial resources, including funds derived or generated from property owned or controlled directly or indirectly by the designated individuals and entities. These measures are maintained for the reasons of national and international security and have been notified to the Fund pursuant to the IMF Executive Board Decision No. 144 (52/51). Malaysia also restricts any dealings or transactions with Israeli/Israel-related entities/individuals as well as in Israeli Shekel; however, since these restrictions affect the underlying transactions themselves, they are not subject to Fund jurisdiction under Article VIII, Section 2(b).

Article IV Consultation:

Malaysia is on the standard 12-month consultation cycle. Staff discussions for the 2024 Article IV consultation took place during December 5–14, 2023.

Financial Sector Assessment Program (FSAP) Participation:

Malaysia conducted its first FSAP in 2012 (IMF Country Report Nos. 13/52, 13/53, and 13/56–13/60).

Technical Assistance:

Fiscal Affairs Department (FAD): A mission discussed options for developing a medium-term revenue strategy (MTRS) in July 2023. The mission also covered tax expenditures assessment and reporting. An MTRS Workshop was held in January 2020. A mission on fiscal responsibility law took place in February 2020. A seminar on treasury management took place in February 2020. A joint workshop on tax policy with MOF was held in July 2016. A mission on expenditure review was conducted in December 2016. A Public Investment Management Assessment (PIMA) mission took place in May 2017. A seminar on treasury modernization was held in July 2017.

Legal Department (LEG): Missions were fielded in May and September 2011 to help draft a Centralized Asset Management Corporations Bill, in the context of a three-year project to assist Malaysia in implementing an asset forfeiture regime.

Monetary and Capital Markets Department (MCM): A mission on macro-financial risk analysis and vulnerability analysis for corporate and financial institutions was conducted in October 2009. A workshop on monitoring financial risks was held in May 2010. Technical assistance missions on stress testing capital markets were conducted in 2013. Technical assistance discussions on further options to deepen FX markets and on analyzing the role of the exchange rate in Malaysia's economy were concluded in March 2021. Technical Assistance on Monetary Policy Modelling in the context of the operationalization of Integrated Policy Framework (IPF tools) has been ongoing since December 2021.

Statistics Department (STA): Technical assistance and training missions on Government Financial Statistics (GFS) have been funded under JSA since 2012, with missions typically conducted annually. These missions have focused on supporting the authorities to improve their GFS and building capacity. Recent missions, (May–June and November–December 2023) have focused on updating the chart of accounts, functional data, state-owned enterprises, and public-private partnerships.

Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT):

In November 2014, Malaysia's AML/CFT regime was subject of an on-site joint assessment by the Financial Action Task Force (FATF) and the Asia Pacific Group on Money Laundering (APG) under the 2013 methodology of the Financial Action Task Force (FATF), the global standard setter for AML/CFT. The Mutual Evaluation Report was published in September 2015. It concluded that overall Malaysia has a broadly robust legal AML/CFT framework with generally well-developed and implemented policies, but with a moderate level of effectiveness. The country developed an action plan to address the key deficiencies identified in the report. In February 2016, the FATF granted full membership to Malaysia based on its commitments to continue improving its AML/CFT regime. The FATF will continue to monitor the country's progress through its enhanced follow-up process. In the Third Enhanced Follow-up Report (October 2018), Malaysia made progress in addressing the technical compliance deficiencies, but remained under the FATF's enhanced follow-up process and will undergo the next round of assessment by the FATF/APG in 2025.

Resident Representative/Advisor: None.

STATISTICAL ISSUES

(As of January 2024)

I. Assessment of Data Adequacy for Surveillance
General: Data provision is adequate for surveillance.
National Accounts: The Department of Statistics Malaysia (DOSM) publishes annual and quarterly estimates of GDP, by the production, expenditure, and (annual only) income approaches, at current and constant 2015 prices, based on the *2008 SNA*. The DOSM also disseminates annual estimates for gross disposable income, saving, and net lending for the economy, as well as supply and use tables. DOSM should plan on updating the base year of Malaysian national accounts to a more recent period as recommended by the *2008 SNA*. **Price Statistics**: The monthly CPI and the PPI are available on a timely and comprehensive basis. A quarterly Services PPI and monthly building cost index are also published. The CPI weights are based on the Household Expenditure Survey for the reference year 2016. The Department of Statistics Malaysia should plan to update the CPI weights as household expenditure patterns will have changed in the intervening years since 2016. The PPI weights are obtained from the Census of Economy 2016 for the reference year 2015 and other alternative sources of data for the value of production. The PPI weights should be updated based on a new Economic Census to reflect the changing structure of production.
Government Finance Statistics: The Malaysian authorities submit annual GFS data on a cash basis to the IMF Statistics Department for budgetary central government. GFS data is currently in the last stages of transitioning to accrual-based accounting for the federal (central) government. Adoption of accrual reporting is necessary to capture a consolidated view of both assets and liabilities. There is a need to improve the timeliness, detail, and collection of data on nonfinancial public enterprises (NFPEs), statutory bodies, and state and local governments. Dissemination of more detailed data on non-listed NFPEs' assets and liabilities and domestic and foreign financing by type of debt instrument and holder would be desirable; efforts in this direction will require continued close collaboration among agencies, including the Ministry of Finance, the Department of Statistics Malaysia (DOSM), and Bank Negara Malaysia (BNM). There is also a need to disseminate more information on public-private partnerships.
Monetary Statistics: The monetary and financial statistics (MFS) are broadly aligned to the Fund's data needs. BNM compiles monetary statistics using the standardized report forms (SRFs) 1SR for central bank and 2SR for other depository corporations for publication in the *International Financial Statistics*. There is a need to improve the institutional coverage of the financial corporations, sectorization of the domestic economy, and classification and valuation of financial instruments to ensure full adherence to the IMF's *Monetary and Financial Statistics Manual and Compilation Guide.* In addition, due to the growing importance of insurance corporations, pension funds, and other financial intermediaries in Malaysia, coverage of MFS should be expanded to include these institutions.
Financial Soundness Indicators: The BNM reports the 15 core financial soundness indicators (FSIs) and nine additional FSIs for deposit takers, and two additional FSIs on real estate markets on a quarterly basis

for posting on the IMF's FSI website. FSIs on other financial corporations, nonfinancial corporations and households are not available. **Financial Access Survey:** BNM reports data on several key series and indicators of the Financial Access Survey (FAS), including mobile and internet banking, mobile money, gender-disaggregated data, and the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).	
External Sector Statistics: Department of Statistics Malaysia compiles and publishes quarterly balance of payments (BOP) and international investment position (IIP) estimates in accordance with the sixth edition of the *Balance of Payments and International Investment Position Manual*. The authorities improved balance of payments and IIP estimates reporting detailed items and narrowing negative net errors and omissions. To further improve the estimates, data for other financial corporations and monetary gold in reserve assets need to be separately identified in BOP and IIP. Malaysia participates in the IMF's Coordinated Direct Investment Survey and Coordinated Portfolio Investment Survey. Malaysia also compiles the Reserves Data Template.	
II. Data Standards and Quality	
Malaysia subscribed to the Special Data Dissemination Standard (SDDS) on August 21, 1996, with metadata published on the Data Standards Bulletin Board (DSBB). Malaysia met SDDS specifications on September 1, 2000. Malaysia is currently using a timeliness flexibility option for general government operations. The latest Annual Observation Report for Malaysia is available on the DSBB.	No Data ROSC is available.

Malaysia: Table of Common Indicators Required for Surveillance
(As of January 30, 2024)

	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange rates	01/30/2024	01/22/2024	D	D	D
International reserve assets and reserve liabilities of the monetary authorities[1]	12/2023	01/08/2024	M	M	M
Reserve/base money	11/2023	12/29/2023	M	M	M
Broad money	11/2023	12/29/2023	M	M	M
Central bank balance sheet	11/2023	12/29/2023	M	M	M
Consolidated balance sheet of the banking system	11/2022	12/29/2023	M	M	M
Interest rates[2]	12/2023	01/10/2023	M	M	M
Consumer price index	12/2023	01/22/2024	M	M	M
Revenue, expenditure, balance and composition of financing[3]—general government[4]	2022	02/10/2023	A	A	A
Revenue, expenditure, balance and composition of financing[3]—federal government	2023: Q3	11/17/2023	Q	Q	Q
Stocks of central government and central government guaranteed debt[5]	2023: Q3	11/17/2023	Q	Q	Q
External current account balance	2023: Q3	11/17/2023	Q	Q	Q
Exports and imports of goods	11/2023	12/21/2023	M	M	M
Exports and imports of services	2023: Q3	11/17/2023	Q	Q	Q
GDP/GNP	2023: Q3	11/17/2023	Q	Q	Q
Gross external debt	2023: Q3	11/17/2023	Q	Q	Q
International Investment Position	2023: Q3	11/17/2023	Q	Q	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing is only available on an annual basis.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A).

Statement by the Staff Representative on Malaysia
February 21, 2024

This staff statement provides updates on developments since the staff report was issued to the Board on February 6, 2024. The thrust of the staff appraisal remains unchanged.

1. **The Malaysian economy recorded an overall growth of 3.7 percent in 2023.** Relative to advance estimates of 3.4 percent, the economy grew by 3 percent in Q4 2023. The slowdown in growth in 2023 was due to the challenging external environment that resulted in a deterioration in Malaysia's trade balance, despite resilient private consumption. The unemployment rate remained unchanged at 3.3 percent in December 2023.

2. **The current account surplus narrowed significantly, to 0.1 percent of GDP in 2023Q4.** This led to an overall current account surplus of 1.2 percent of GDP in 2023, the lowest in over two decades. In addition to the subdued external demand, primary income deficit, due to higher investment income accrued to foreign investors in Malaysia, also contributed to the narrowing of the current account surplus. External debt remains manageable at 68 percent of GDP at end-2023.

3. **Gross international reserves (GIR) amounted to US$114.8 billion at end-January 2024.** GIR remained broadly unchanged relative to their level of US$115.1 billion at mid-January 2024. Net international reserves (NIR) as of end-2023 stood at US$75.3 billion, an increase relative to US$71.3 billion at end-2022. Over the last year, the gap between the GIR and NIR also decreased, by about US$5 billion, due to a decline in both BNM's short forward positions and FX deposits.

Statement by Raja Anwar, Alternate Executive Director for Malaysia, and Ahmad Faisal Bin Rozimi , Advisor to the Executive Director
February 21, 2024

Introduction

1. On behalf of our Malaysian authorities, we would like to convey our appreciation to the mission team, led by Mission Chief Mr. Lamin Leigh, for the constructive 2024 Article IV consultation and the comprehensive staff report. Our authorities value the engagements and policy discussions with the Fund. They broadly agree with the overall thrust of staff's appraisal and will carefully consider the policy recommendations.

Recent developments and outlook

2. The Malaysian economy remains resilient to external headwinds, with solid economic performance in 2023. Growth was driven by domestic demand following continued employment and wage growth, and investment activity. Further recovery in tourism activity following higher tourist arrivals and spending provided a further impetus to growth. Both headline and core inflation moderated to 2.5% and 3.0%, respectively, reflecting lower cost pressures amid stabilizing demand conditions.

3. Moving forward, Malaysia's growth is projected to improve to between 4.0 and 5.0 percent in 2024, supported by the resilient domestic expenditure, recovery in exports and further improvement in tourism activity. Employment and wage growth will remain supportive of household spending. Investment activity would be supported by progress of multi-year projects, robust approved investments and implementation of catalytic initiatives under the national master plans. Malaysia's diversified trade structure across products and markets alongside a robust business ecosystem and investment climate will continue to ensure Malaysia's resilience against external risks.

Macroeconomic policies

4. Malaysia's fundamentals are further underpinned by sound macroeconomic policies as well as robust regulatory and supervisory frameworks.

   - **Fiscal policy**: Our authorities note the staff's assessment that the fiscal consolidation strategy set out in the 2024 Budget is appropriate. The enactment of the Public Finance and Fiscal Responsibility Act 2023 (Act 850) in October 2023 reflects our authorities' resolve for bold reforms to strengthen public finances and financial management while bolstering governance, transparency and accountability.

   - **Monetary policy**: Our authorities also note the staff's assessment that Malaysia's monetary policy stance is appropriate. The Monetary Policy Committee (MPC) of Bank Negara Malaysia (BNM) will continue to be data-driven and remains vigilant to ongoing developments to inform the assessment on the outlook for domestic inflation and growth.

- **Exchange rate policy**: The flexible exchange rate continues to be the first line of defense against shocks. BNM's foreign exchange interventions (FXI) remain limited to ensure orderly domestic foreign exchange (FX) market functioning. Our authorities noted that the staff welcome the initiatives undertaken by BNM to liberalize and deepen the FX market, which has increased daily FX turnover.
- **Financial sector**: Malaysia's resilient financial system continues to record robust capital and liquidity positions, with strong asset quality and healthy banking system profitability as well as low non-performing loans (NPLs). Our authorities agree with staff that systemic risks remain contained.
- **Structural reforms**: Our authorities remain highly committed to deepen structural reforms to boost Malaysia's medium-term economic growth potential. Reform initiatives are aimed at accelerating quality investment and raising wages and productivity, including by creating high-skilled and high-income jobs. These efforts will focus on spurring innovation and accelerating modern technology diffusion, with emphasis on climate resilience and sustainability.

Policy recommendations

Monetary policy

5. Our authorities take note of staff recommendation to maintain a tightening bias for monetary policy to manage upside risks to inflation from the planned gradual subsidy reform and other supply-side factors. Staff assessed the output gap will remain positive in 2023 and 2024.

6. However, our authorities also note that staff assessed the balance of risks to growth is tilted to the downside, arising mostly from external factors. At the same time, both headline and core inflation continued to decline to modest levels of 1.5 and 1.9 percent, respectively in December 2023. Given modest underlying inflation as measured by core inflation, our authorities emphasize that further assessment is required especially on the inflation propagation and transmission channels, including on the potential second-round effects arising from the upside risks to inflation.

7. It is worth reiterating that the MPC considers the outlook and balance of risks for domestic inflation and growth in deciding monetary policy. As mentioned in the January 2024 monetary policy statement, the MPC will ensure that the monetary policy stance remains conducive to sustainable economic growth amid price stability.

Exchange rate policy

8. Our authorities assess that the recent depreciation of the ringgit is not reflective of Malaysia's economic fundamentals and prospects. In this regard, our authorities broadly share the staff's assessment that Malaysia's real exchange rate appreciation over the medium term is warranted.

9. However, our authorities continue to see limitations of the Fund's external balance assessment (EBA) model and findings, following the persistently weak explanatory power of the model in the context of Malaysia. Some assertions also require further analysis. For example, the staff assessment of persistent positive CA gap over the past years contributed in part by precautionary savings may require refinement given the staff's articulation of retirement income insecurity for a large proportion of Malaysians.

10. The recommendation by staff to gradually phase out existing capital flow management measures (CFMs) needs to consider the broader perspective and take account of the domestic context and circumstances. Our authorities emphasize that these measures are not meant to restrict capital flows but are prudential in nature, or essential for domestic FX market development and resilience. The measures contribute to financial and monetary stability.

Macroprudential policy

11. Policies are contingent on the risks being managed. Our authorities broadly agree with the staff's recommendation for further pre-emptive broadening of the macroprudential toolkit, to ensure that the variety of tools (such as the possible introduction of sector-wide loan-to-value (LTVs) on first and second properties) are ready to be deployed to address any risk build-up. At this stage, our authorities assess that the current set of macroprudential measures is broadly appropriate given sizable financial buffers and minimal speculative activity in the real estate sector. Any additional pre-emptive macroprudential tools will continue to be based on assessments of economic and financial developments and the potential risks to financial stability.

Retirement and pension system

12. Reforming Malaysia's overall social protection system, including old-age retirement savings and security remains a key policy agenda for the nation. Our authorities disagree with the staff appraisal that a clear action plan to ensure a sustainable pension system is missing from the policy agenda. Key initiatives have been implemented with further measures expected to be rolled out moving forward, including:

- **Raising wages**: While Malaysia has good mandatory contribution rates to the Employee Provident Fund (EPF), low wages have impacted the amount of accumulated retirement savings. As Malaysia introduced the Minimum Wage Order (MWO) around a decade ago in 2013 and has progressively raised the minimum wage levels since then, tangible improvement especially for the low- income earners will trickle in for the future cohorts of retirees. Our authorities remain committed to review the national minimum wage every two years. In addition, a White Paper on the Progressive Wage Policy (PWP) has been tabled in the latter part of 2023, with a pilot project slated to take off in June this year. This productivity-linked policy alongside other upskilling and retraining programs are expected to lift Malaysia's median wage and the labor income share, thus boosting retirement savings.

- **Enhancing coverage**: To boost the coverage of old-age retirement savings beyond the standard and formal employment, the EPF has introduced voluntary schemes with incentives from the government to self-employed, gig workers and housewives. The Malaysia Social Protection Council (MySPC) is undertaking a comprehensive study to expand the social protection to working Malaysians who reach the age of 18. This will enhance the social protection coverage and boost old-age income security, especially for the vulnerable groups and those in the non-standard employment and informal sector.

13. Our authorities' firm stance on not allowing further pandemic-era withdrawals from the EPF will safeguard the retirement funds. Our authorities remain highly committed to ensure retirement and old-age security in the country, with emphasis on enhancing coverage, boosting retirement savings and ensuring adequacy throughout the post- retirement period. This policy will be advanced together with the planned comprehensive social protection system to ensure a smooth transition of the economy as the population ages.

Final remarks

14. The Malaysian authorities remain committed to sound macroeconomic management with robust regulatory and supervisory frameworks, while deepening structural reforms. Our authorities look forward to continued engagements and strong collaborations with the Fund, including on capacity development and policy discussions.