Pandemic Economics: the impact of the COVID-19 pandemic on the Malaysian economy[1]

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Synopsis

- COVID-19 has had devastating impacts on the Malaysian economy. The sources of damage to the Malaysian economy are twofold: The first is the external, arising from the impacts of the coronavirus abroad; while the second is domestically generated due mainly to earlier nationwide movement restrictions.
- In terms of economic growth, the impacts from the crisis have been severe. The Malaysian economy contracted by 17.1 percent year-on-year in 2Q2020--the steepest amount since the aftermath of the Asian Financial Crisis in 1998.
- The COVID-19 crisis has also deeply affected the Malaysian labour market and Malaysian workers. The unemployment rate is still hovering at multi-decade highs, while marginalised worker groups like women, youth, and lesser-educated workers have been the hardest hit by the COVID-19 crisis.
- There is still room for more fiscal expansion. Due to the unprecedented nature of the COVID-19 crisis and the large distributional impacts, policy action can go even further to alleviating some of these pressures in the immediate-term as well as increasing economic growth and productivity for the longer-term.

Malaysia's first COVID-19 case was detected on 25 January 2020. By March, the number of new daily coronavirus infections had risen significantly, prompting the Malaysian government to announce nationwide movement restrictions on 18 March 2020. Despite initially doing well in curbing infection rates—with the nationwide movement restrictions gradually relaxed by May 2020—a new wave of infections started in September 2020. The case numbers have ballooned again.

Beyond public health, COVID-19 has had devastating impacts on the Malaysian economy. The sources of economic damage are twofold: external, arising from the impacts of the coronavirus abroad, including softer external demand and greater global uncertainty; and domestically generated due to income and production impacts arising from the implementation of social distancing and closure requirements as part of the nationwide movement controls.

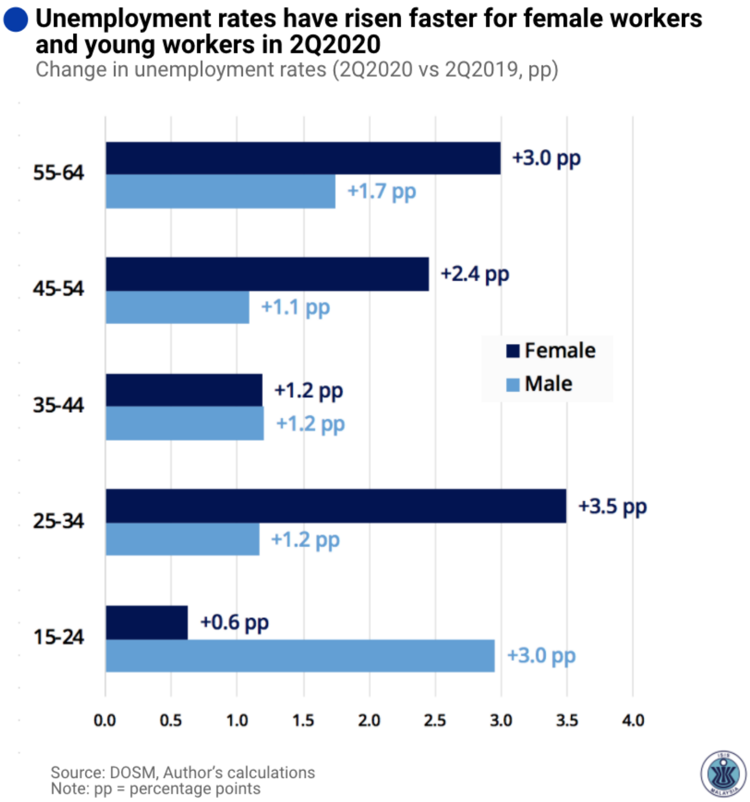
The main external channel of transmission of the COVID-19 shock is through trade linkages (Cheng 2020 b). Lockdown measures worldwide have reduced global demand for Malaysia's exports, which was already facing pressure in 2018 and 2019 from increased trade uncertainty amid the US-China trade conflicts. This is compounded by the fact that the Malaysian economy is amongst the highest exposed to trade and is amongst the most connected in terms of global value chains in the Asia Pacific region. The second source of

[1] Presentation slides: https://www.isis.org.my/2020/10/08/pandemic-economics-impacts-of-covid-19-on-the-malaysian-economy/

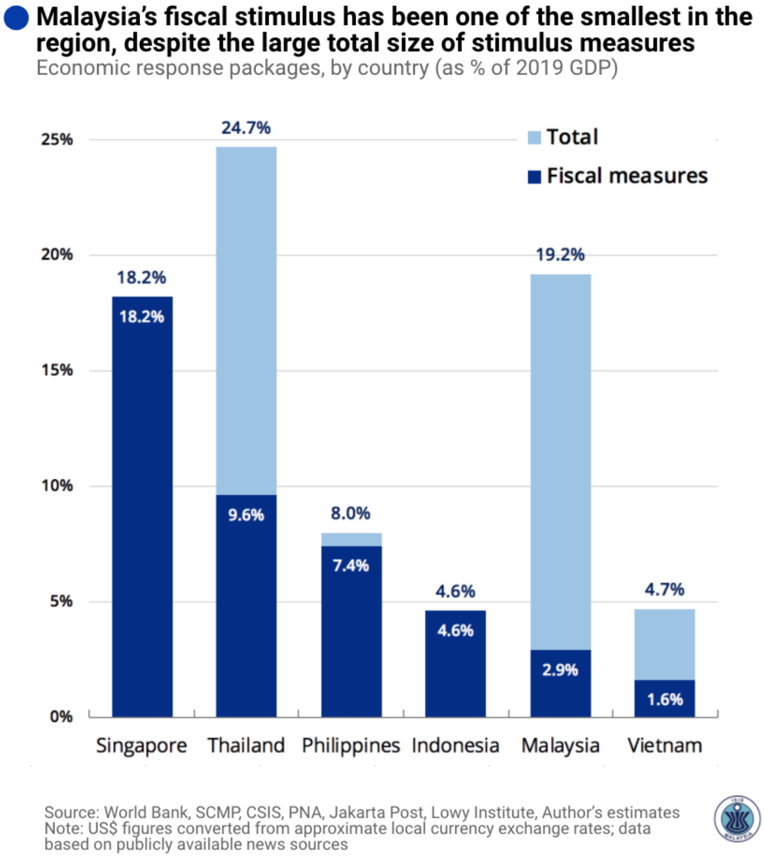
economic shocks is domestic. The movement restrictions, while an essential measure to reduce the outbreak of the coronavirus in Malaysia, has had enormous economic costs. The mandated closure of businesses and services and movement restrictions has devastated consumption and investment and created wide-ranging impacts on both supply and demand.

In terms of economic growth, the impacts from the crisis have been severe. The Malaysian economy contracted by 17.1 percent year-on-year in 2Q2020—the steepest amount since the aftermath of the Asian Financial Crisis in 1998. Subsequently, the gradual relaxation of movement controls allowed the pace of decline to ease, with Malaysia's 3Q2020 GDP (gross domestic product) recording a 2.7 percent decline. But unlike the swift economic recovery Malaysia made during the aftermath of the Global Financial Crisis in 2009, this time around, Malaysia's recovery to pre-crisis levels of GDP will be slow (Cheng 2020a). Back in 2009, a sharp recovery in oil and electronic exports along with a surge in foreign investment allowed GDP to return to pre-crisis levels in less than a year. Today, low global energy prices, muted demand from the world's major economies, and a likely slow recovery in global trade make a "V-shaped" recovery far less likely.

Besides its effects on economic growth, the COVID-19 crisis has also adversely affected the Malaysian labour market and Malaysian workers. Measures of labour market slack reached the highest levels in decades, with recent data showing the headline unemployment rate still hovering at multi-decade highs even as movement controls have been relaxed. Yet, beyond the headline unemployment rate, recent research has also shown that there have been drastic distributional impacts in Malaysia (Cheng 2020d). Marginalised worker groups like women, youth, and lesser-educated workers have been the hardest hit by the COVID-19 crisis, while higher-educated male workers have been largely protected from the employment impacts of the pandemic. At the same time, there is evidence of high levels of labour market exit for women and youth workers in recent months as labour market conditions deteriorated (Cheng 2020d). Overall, the crisis has deepened existing inequalities in the economy and society.



In response, the Malaysian government has allocated an estimated RM 305 billion in fiscal and non/quasi-fiscal measures to respond to the COVID-19 crisis since the start of the year to November 2020. However, while the total announced package size amounts to about 20 percent of GDP, actual fiscal measures only amount to about 3.8 percent of GDP, or about RM 55 billion. The remaining RM 250 billion consists broadly of non-fiscal or quasi-fiscal measures, including initiatives like moratoriums on debt repayments and loan guarantees for small businesses, which are borne not by the federal government—but by government-linked entities or by the financial sector. Indeed, in terms of actual fiscal measures, estimates based on publicly available reports suggest that Malaysia's fiscal measures to combat COVID-19 (as a percentage of GDP) is actually the second-lowest in the ASEAN region after Vietnam.



Yet, due to the unprecedented nature of the COVID-19 crisis and the large distributional impacts, policy action can go even further to alleviating some of these pressures in the immediate-term as well as increasing economic growth and productivity for the longer-term (Cheng 2020c).

The first is to further expand and improve social safety net programs like Malaysia's Employment Insurance Scheme (EIS) unemployment insurance program and the Bantuan Sara Hidup (BSH) income-targeted cash transfer program. Temporarily relaxing eligibility and increasing the coverage of social assistance programs for workers and households can help vulnerable groups better weather the unprecedented shocks from the COVID-19 crisis. Simultaneously, making efforts towards consolidating fragmented social assistance programs into fewer large programs administered by a single ministry/agency will increase administrative efficiency, reduce targeting costs and make it easier for beneficiaries to apply for and receive social assistance.

Secondly, increasing government spending even further to boost aggregate demand and tighten labour markets will greatly benefit marginalised and vulnerable worker groups the most. Even as multiple stimulus packages are already underway, there is still room for fiscal expansion—particularly if economic conditions worsen further in the coming months. Here, government spending can be focused on increasing infrastructure spending. Research shows that raising infrastructure spending can raise long-term productivity and economic growth, especially if financed by higher government deficits and undertaken during a recession (Stupak 2018).

Thirdly, improving fiscal space by relaxing fiscal rules and improving government revenue sustainability. The required increase in government spending and expansion of various stimulus packages would mean that the government will eventually need to contend with fiscal rules that limit its ability to spend. The most urgent would be to amend fiscal rules that restrict the use of debt to finance operating expenditure. This would require an act of parliament to temporarily allow the use of debt to finance the increase in operating expenditures from the COVID-19 economic response packages. Furthermore, diversifying Malaysia's government revenue streams need to be done via increasing revenue collection from consumption taxes while broadening the tax base and increasing tax compliance.

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