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STRUCTURAL ECONOMIC REFORMS: NO TIME TO LOSE

The Malaysian economy remains in recession, though it is slowly stirring back to life. In 3Q2021, the economy contracted by 4.5%, compared with the previous quarter's expansion of 16.1%.

On a quarter-on-quarter (q-o-q) seasonally adjusted basis, the economy appears to be undergoing a W-shaped recovery, with 3Q2021's GDP growth of -3.6% marking the turning point of the second trough of the "W". For the full year 2021, we estimate GDP growth to come in at 3.3%.

Amid economic scarring and elevated uncertainties, we remain cautiously optimistic about Malaysia's recovery prospects in the coming quarters. The recovery momentum should improve as the vaccination rate rises and the economy reopens further. However, the emergence of the newly identified COVID-19 variant Omicron could pose further downside risks to the recovery outlook.

For 2022, the Government expects its proposed record high 2022 Budget allocation of RM332.1 billion to boost economic growth to 5.5%-6.5%. We expect GDP growth to come in within the government's forecast range but near the lower bound at 5.6% if the economic reopening is not disrupted again by lockdowns and COVID-19 resurgences.

Unlike past crises, the game-changing COVID-19 pandemic had not only triggered demand but also supply shocks. With the pandemic having also upended the supply side of the economy, policymakers must thus be mindful of not fighting the last war. To put it simply, the Government's evolving policy mix must be strongly supportive of businesses.

As the economy is still in recession, business conditions remain tenuous. In 3Q2021, the Malaysian Institute of Economic Research's (MIER) Business Conditions Index still came in below the 100-point threshold at 97 points. The reading below the 100-point threshold indicates that the manufacturing sector remained in contractionary mode in the third quarter.

It is worth pointing out that the manufacturing sector has been stagnating. In the aftermath of the 1997 Asian Financial Crisis (AFC), the sector's contribution to overall GDP fell into a declining trend (2000: 30.9%; 2019: 21.4%), as did its share of employment (2000: 23.5%; 2019: 17.8%)

The twin decline in manufacturing's share of output and employment – a sign of deindustrialisation – points to falling productivity and competitiveness. As Malaysia has yet to fully industrialise, the phenomenon also reflects weakening opportunities for industrialisation.

Malaysia's premature deindustrialisation is strong evidence of its weakening growth dynamics post-AFC. We think this is one reason why the nation remains stuck in the middle-income trap.

In view of the destructive impact of the pandemic, we expect deindustrialisation to pick up in pace. This is a critical concern because the manufacturing sector is an important source of technological innovation and productivity gains. It is worth noting that even before the pandemic hit, labour productivity growth in the manufacturing sector had been slowing down (2017: 3.9%; 2018: 2.4%; 2019: 1.7%).

Thus, there is no time to lose.

Over the short term, the Government will inevitably need to work on economic normalisation and recovery, for instance, easing supply chain bottlenecks and disruptions. This is because bottlenecks and disruptions can feed off one another and choke off resurgent domestic demand. The consequences for economic recovery are obvious.

However, even as we climb out of this crisis, the Government must also start working on long term structural reforms targeted at the supply side of the economy. Malaysia urgently needs reforms that can support industrial upgrading, improve productivity growth and resilience, as well as create new forms of businesses. Without these developments, it will continue to deindustrialise.

In the final analysis, we must avail ourselves of a robust and dynamic supply side if we want to regain lost ground, surpass our regional competitors, and maintain our lead post-COVID-19. Structural reforms under the Twelfth Malaysia Plan must thus begin as soon as possible in the coming budget year. We cannot afford to wait until after the pandemic crisis ends -- after all, nobody knows when that will happen.

This article is co-authored by The Malaysian Institute of Certified Public Accountants (MICPA) & Malaysian Rating Corporation Berhad (MARC).