

# Assessing The 2023 Unemployment Outlook

## Challenges and Opportunities Ahead



### Summary

- ◆ Monitoring the unemployment rate is important for policymakers to make informed decisions about economic policy and to ensure that the economy is healthy and robust. It helps policymakers to make informed decisions about economic policy, including monetary and fiscal policy, and identify intervention areas that may be needed.
- ◆ EU-ERA estimates the unemployment rate would be around 3.45% to 3.75% for the year 2023, which the actual expectation depends on the GDP growth rate. If GDP grows at a rate of 4.5%, the unemployment rate is projected to reach 3.45%. If the economy is able to grow at a rate of 6.5%, the unemployment rate is expected to decrease to 3.45%. Nevertheless, the estimated unemployment rates in 2023 have not yet returned to the pre-pandemic situation which reached 3.3% in 2019.
- ◆ There are some recommendations to speed-up the employment absorption in the economy which include raising wages, boosting demand through high-employment multiplier sectors, interventions to improve labor supply outcomes and optimizing job creation through inclusive hiring and improved job matching mechanism. As far as the 2023 target is concerned, the recommendations are more relevant for short-term measures instead for medium-term interventions.

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## Monitoring Labor Market

The labor market outlook is important for policymakers because it provides critical information about the state of the economy and the health of the labor market. The unemployment rate, wage growth, skills gap and inflation are among the key indicators for policymakers to make informed decisions about economic policy, including monetary and fiscal policy.

**Unemployment rates.** If unemployment rates are high, policymakers may need to implement policies to stimulate job creation and boost economic growth.

**Wage growth.** It is an important indicator of economic health and policymakers may need to adjust policies to encourage wage growth, which can help reduce income inequality and boost consumer spending.

**Skills gap.** Policymakers use skills gap or mismatch between the skills that workers have and the skills that employers need to implement policies to encourage education and training programs to help workers gain the skills they need to compete in the labor market.

**Inflation.** If labor market conditions are tight, with low unemployment and high demand for workers, it can lead to wage inflation and ultimately consumer price inflation. Policymakers can use this information to adjust monetary policy to keep inflation in check.

This Policy Brief offers a limited view by focusing on the outlook for the unemployment rate in 2023.

## Economic Growth and Unemployment in 2022

Gross domestic product (GDP) growth and unemployment are linked to the demand for labor. When the economy is growing, businesses tend to hire more workers to meet the increased demand for goods and services, leading to lower unemployment rates. Conversely, when the economy is contracting, businesses tend to lay off workers, leading to higher unemployment rates. This is the reason why the unemployment rate is always linked to GDP growth.

Economic growth in 2022 is impressive, as shown in Figure 1. The GDP grows at a rate of 8.7% supported

## Importance of Unemployment Outlook

The unemployment rate is an important economic indicator that measures the percentage of the labor force that is unemployed, including active and inactive workforces. Monitoring the unemployment rate is important for policymakers to make informed decisions about economic policy and to ensure that the economy is healthy and robust. It helps policymakers identify areas where additional support may be needed.

Here are key reasons why the unemployment rate is important to be monitored.

**Overall health of the economy.** The unemployment rate provides a snapshot of the overall health of the economy. A low unemployment rate is often seen as a sign of a healthy economy with robust job growth and strong consumer spending.

**Consumer confidence.** A low unemployment rate can also contribute to higher levels of consumer confidence, which can lead to increased consumer spending and economic growth.

**Fiscal policy.** The unemployment rate can be used by policymakers to make decisions about fiscal policy, including tax rates and government spending. A high unemployment rate may signal the need for fiscal stimulus measures to boost job creation and economic growth.

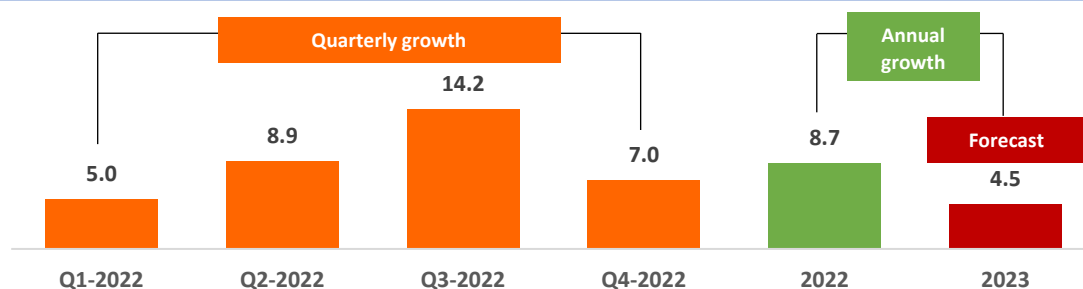
**Monetary policy.** The unemployment rate is also an important factor in monetary policy decisions. Central banks may adjust interest rates based on the unemployment rate to stimulate or cool down the economy.

**Social implications.** Unemployment can have significant social implications, including increased poverty, decreased mental health and well-being, and increased crime rates.

by strong economic growth in the third quarter which recorded growth of 14.2%. Economic growth in 2023 is expected to grow more slowly with an expected growth rate of 4.5%. The relatively slower economic growth is projected after taking into account the global economic slowdown. The geopolitical crisis, especially the Russia-Ukraine war, inflationary pressure in most of Malaysia's main trading partner countries, global supply chain disruptions and labor shortages are the main factors contributing to downward global economic growth.

Figure 1

Gross domestic product growth rates (%), 2022



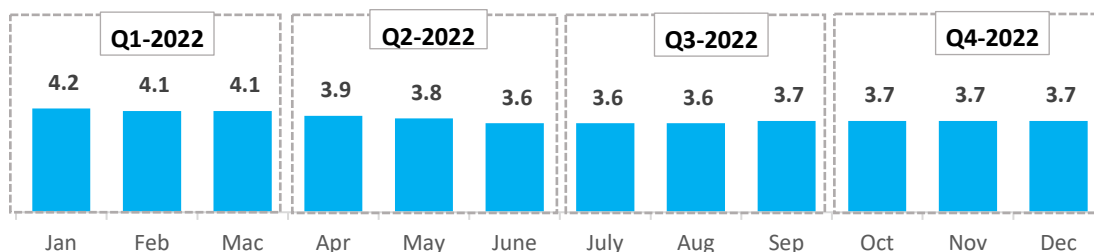
Source: Department of Statistics Malaysia (2022) and Ministry of Finance Malaysia (2023)

High economic growth in 2022 has contributed to the recovery of the unemployment rate. The rising economic growth in the first to third quarter has contributed to the decrease in the unemployment rate, as shown in Figure 2. A significant decrease in the unemployment rate can be observed in the second quarter. Although GDP expands from 8.9% in the second quarter to 14.2% in the third quarter, the unemployment rate in the third quarter remained at around 3.6%. Economic growth in the fourth quarter which slowed to 7.0% compared to 14.2% in the third quarter, has contributed to an increase in the unemployment rate to 3.7%.

There are two implications from the analysis of economic growth and the unemployment rate as seen in Figure 1 and Figure 2. First, high growth is needed to restore the labor market and maintain the unemployment rate at pre-pandemic levels. High growth is needed to restore workers affected by the pandemic crisis in the period 2020-2021 and create job opportunities that match their skills. Second, salary and wage rates and the effectiveness of job placement approaches are expected to influence a large part of the magnitude of employment absorption.

Figure 2

Monthly unemployment rates (%), January to December 2022



Source: Department of Statistics Malaysia (2022)

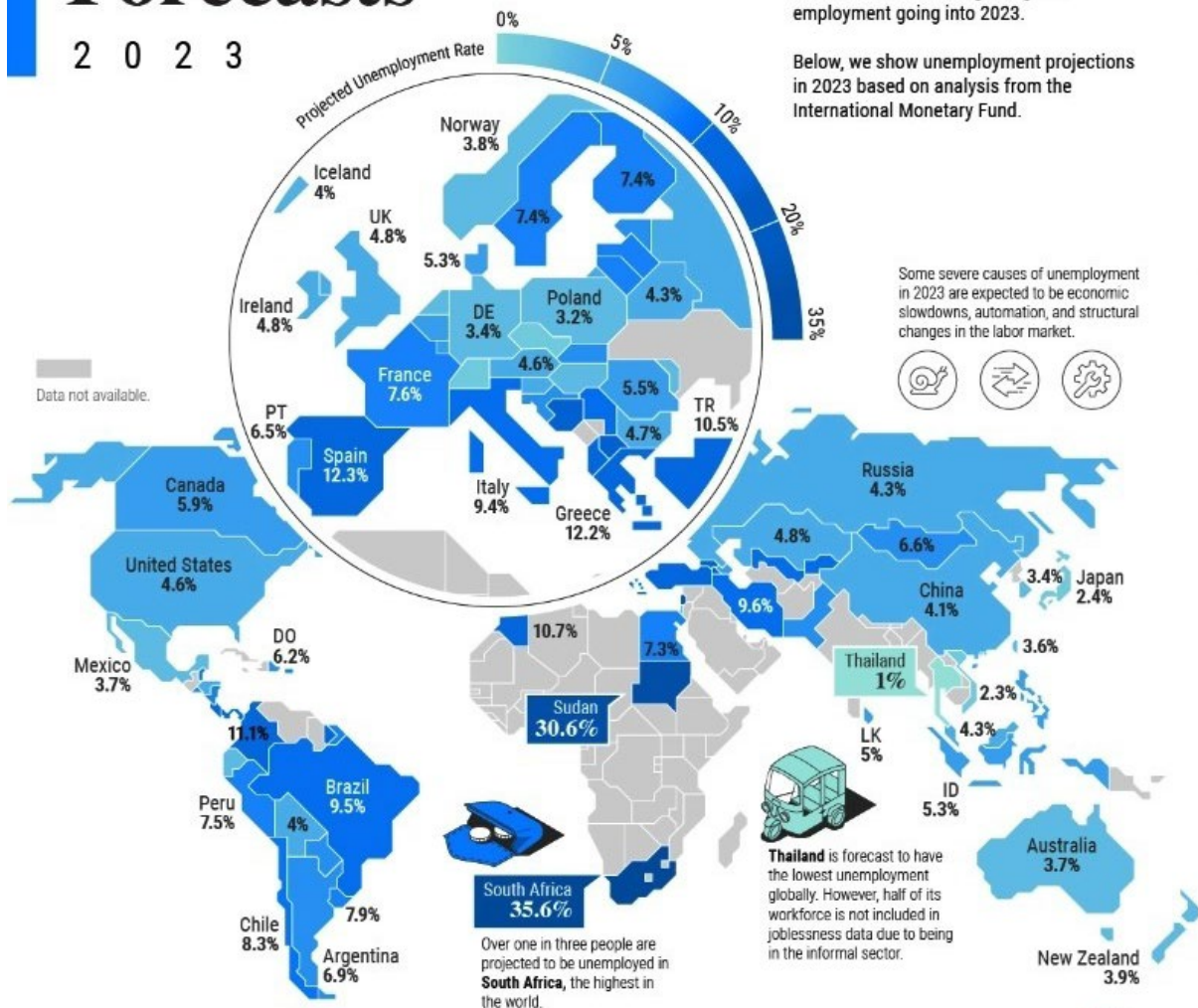
Unemployment Outlook 2023

In the below infographic, we present world unemployment forecasts in 2023 mapped by the World Economic Forum (WEF) using data from the IMF’s World Economic Outlook. According to the IMF estimates, the unemployment rate in Malaysia in 2023 is projected to reach 4.3%. In our view, this estimate is higher compared to the actual

unemployment rate of 3.6% in January 2023 reported by the Department of Statistics Malaysia (DOSM). This level of unemployment has maintained since November 2022. The methodological approach of IMF that includes large countries and the used of data and assumptions in the model may contribute to the differences.

# Unemployment Forecasts

2023



Sources: IMF World Economic Outlook (Oct 2022), Nikkei, The Balance Money (2022)

## EU-ERA estimates

The Ministry of Finance Malaysia estimates that the GDP growth in 2023 would be at 4.5%. Using this information, we develop a simple econometric model to forecast the implication on the unemployment rate. Our econometric model is developed based on the labor demand function. When GDP is expanding, businesses are growing and the businesses tend to hire more workers with directly contributes to the decline in the unemployment rate. Conversely, when the economy is contracting, businesses tend to lay off workers, leading to higher unemployment rates.

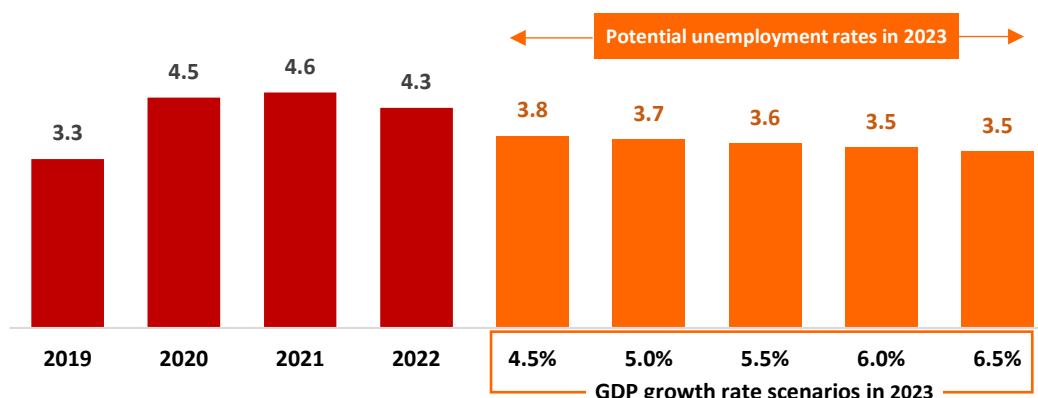
In our view, 4.5% growth rate can be considered as lower-bound and the economy has the opportunity to accelerate further, given the current global

economic condition. Thus, we include scenario simulations in our analyses by examining the unemployment impacts of 5.0%, 5.5%, 6.0% and 6.5% of GDP growth.

Our estimates in Figure 3 show that the unemployment rates in 2023 would be around 3.45% to 3.75%, depending on the targeted GDP growth. The estimates indicate that our economy in 2023 has the capacity to reduce the unemployment rate below 4%, which is considered a full-employment condition. It also shows a continuous improvement in the unemployment rate compared to 2021 and 2022 conditions. Nevertheless, the estimated unemployment rates in 2023 have not yet returned to the pre-pandemic situation which reached 3.3% in 2019.

Figure 3

Actual and estimated unemployment rates (%), 2019-2023



Source: Unemployment rates for 2019 to 2022 are sourced from the Department of Statistics Malaysia (2022) while different 2023 unemployment rate scenarios are estimated by Centre for Future Labour Market Studies (EU-ERA)

Approach for Unemployment Forecast

To forecast the unemployment rate for Malaysia, we utilize the standard multiple regression model, using Ordinary Least Square with robust standard error due to the Newey-Wise procedure. The estimated equation is specified as follows,

$$u_t = \alpha_0 + \sum_{i=0}^3 \beta_i y_{jt} + \sum_{i=1}^2 \gamma_i u_t + \delta_1 t + \delta_2 t^2 + \delta_3 t^3 + \epsilon_t$$

where  $u_t$  is the unemployment rate,  $y_t$  is real GDP with five ( $j$ ) different forecasted GDP growth for 2023 at 4.5%, 5.0%, 5.5%, 6.0% and 6.5%. The variables  $t$ ,  $t^2$  and  $t^3$  are time trend representing linear, quadratic and trend to the power 3 (cubic relationship). The error term  $\epsilon_t$  is assumed to has zero mean and constant variance. Equation (1) is estimated for unemployment rate at the national, and sub-sectors.

Annual data on unemployment rates and real GDP for the period 1982 to 2021 are collected from various publications by the Department of Statistics Malaysia (DOSM). Data for real GDP for 2022 are accessed from the International Monetary Fund, World Economic Outlook Database, October 2022.

Key Interventions to Speed-Up Employment

Here are some recommendations to accelerate the recovery of the unemployment rates and the labor market as a whole. As far as the 2023 target is concerned, the recommendations are more relevant for short-term measures instead for medium-term interventions.

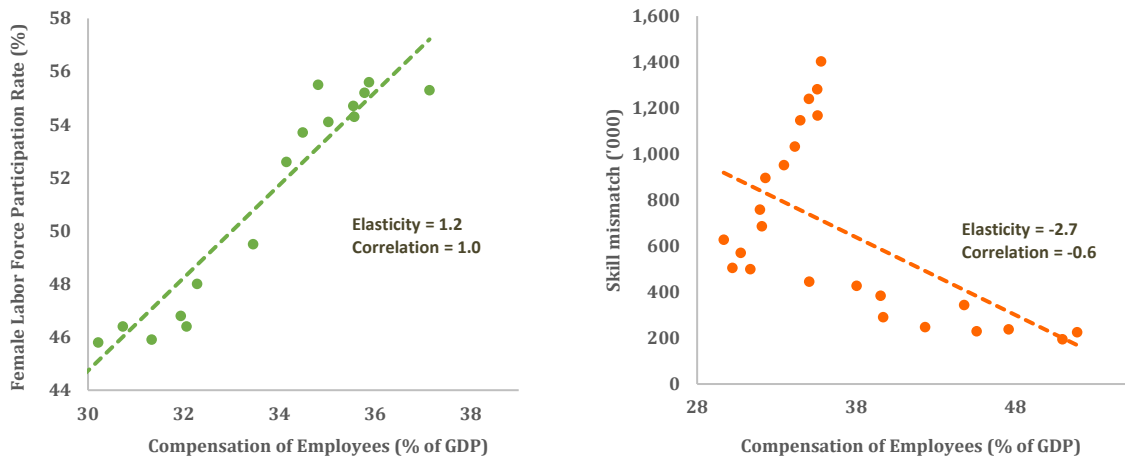
**Rising wages to increase employment and reduce the skill mismatch.** Higher wage is found to be the answer for some of the structural issues in Malaysia, including the low women labor force participation and mismatch. There is evidence to suggest that a modest increase in wages is unlikely to harm the economy and may, in fact, have positive effects. Increase in wage impacts the economy in two ways. Firstly, an increase in wages

can stimulate consumer spending. When workers earn more money, they are likely to spend more, which can increase demand for goods and services, leading to increased economic activity and job creation. Secondly, an increase in wages can lead to lower turnover and higher employee productivity. When workers are paid more, they are more likely to remain with their employer, reducing the costs associated with turnover. Additionally, higher wages can increase worker motivation and productivity, leading to improved quality and efficiency in the workplace.

An empirical assessment as shown in Figure 4 suggests that a 1% increase in wage tends to increase women labor force participation rate by 1.2%. The size of skill mismatch can be reduced by 2.7% for every percentage increase in wage

Figure 4

Relationship between the compensation of employees and female labor force participation and skill mismatch



Source: Estimated by Centre for Future Labour Market Studies (EU-ERA)

Estimating employment elasticities

Employment ( $e$ ) elasticity with respect to real GDP ( $y$ ) is the percentage change in employment divided by the percentage change in real GDP, that is,  $\% \Delta e / \% \Delta y$ .

In a regression, we estimate the following model,

$$\ln e_t = \alpha + \beta \ln y_t + \mu_t$$

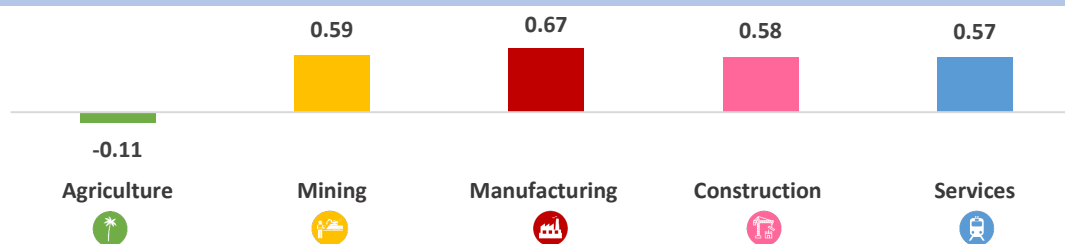
where  $\ln e_t$  and  $\ln y_t$  are employment and real GDP respectively, in logarithm. Since the above equation is log-log specification, the estimated coefficient  $\beta$  is elasticity. In other words, we can interpret the estimated regression as a percentage change in employment in response to the percentage change in real GDP. The above equation is estimated using Ordinary Least Square with robust standard error due to Newey-Wise procedure. Annual data on the number of employments for the period 1982 to 2021 are collected from the Department of Statistics Malaysia (DOSM).

**Boosting labor demand through high-employment multiplier sectors.** This approach refers to the strategy of targeting economic sectors that have a significant impact on job creation throughout the economy. These sectors are known as high employment multiplier sectors, as they create jobs not only within their own industry but also in related industries that supply goods and services to them. We have estimated employment elasticity to GDP in Figure 5 for five main sectors. The Services and manufacturing sectors are the main sources of employment absorption, contributing 64.9% and

16.6% to the total employment in 2021. These two sectors also show considerable elasticity of employment in response to GDP growth. Thus, concentrating efforts for employment creation and placement in these two sectors would contribute to a considerable unemployment reduction. For the growth stimuli strategy, outward orientation through export expansion is the key growth for the manufacturing sector and inward orientation through domestic consumption is the key expansion for the services sector.

Figure 5

## Employment elasticities for main economic sectors



Source: Estimated by Centre for Future Labour Market Studies (EU-ERA)

**Crucial interventions to improve labor supply outcomes.** Multidimensional approaches to incentivize people to work and realign workforce skills and proficiencies to meet industry demand are keys to supporting economic production. Youth unemployment, women participation, graduate employability and older workers are among the supply-side segments that required specific interventions. The transition of talent development from supply-driven to demand-driven is expected to accelerate the employment placement.

**Optimizing job creation through inclusive hiring and improved job matching mechanism.** Since the pandemic hit, economic sectors suffer from labor shortages. An inclusive intervention has been implemented to maximize local talents to fill up the vacancy gap. Data management for hiring and matching should be inclusive to capture wage and non-wage indicators that are essential for determining placement and retention. For example, reducing the opportunity costs (e.g. housing and childcare costs) of labor migration to enhance the benefits for workers and destinations. In addition to that non-wage indicators such as working environments and employer-employee relations are important determinants for youth workers.

## Limitations and assumptions

There is an inverse relationship between GDP growth and unemployment, meaning that when the economy is growing, unemployment tends to decrease, and when the economy is shrinking, unemployment tends to increase. This policy brief forecasts the unemployment rates by using aggregated GDP growth rate as the input. Equally important to note that the relationship between GDP growth and unemployment is complex and can be influenced by many factors.

Here are some key points to consider:

**Productivity.** When productivity increases, businesses can produce more goods and services with fewer workers, leading to lower demand for labor and potentially higher unemployment rates. However, in the long run, higher productivity can lead to higher economic growth, which can eventually result in lower unemployment rates.

**Government policy.** Government policy can also play a role in the relationship between GDP growth and unemployment. For example, fiscal policies such as tax cuts or government spending can stimulate economic growth, leading to lower unemployment rates. Monetary policies such as interest rate adjustments can also impact economic growth and employment levels.

**Structural changes.** Structural changes in the economy, such as changes in technology, globalization, or demographics, can also affect the relationship between GDP growth and unemployment. For example, technological advances can lead to increased productivity and economic growth, but can also result in job displacement and higher unemployment rates in certain industries.

The above indicators are excluded from our estimation model under the ceteris paribus clause. In addition to the GDP, the movements in productivity, government policy and structural changes would change the unemployment rates. Implicitly, our estimation assumes that the current productivity level and government policy would continue without considerable structural changes. This situation is also known as business-as-usual scenario.

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### EU-ERA Policy Brief


EU-ERA Policy Brief offers a short note with combined analysis and policy recommendations in addressing developmental issues that are directly and indirectly affect the labor market in Malaysia. This policy brief aims to generate a forward-looking and proactive discussion among policymakers, researchers and stakeholders in identifying emerging trends, challenges, and opportunities in the economy. The orientation is toward the real-world policy challenges and opportunities, with an emphasis on providing practical recommendations that can help guide decision-making.


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Centre for Future Labour Market Studies (EU-ERA) is a state-of-the-art research centre in Malaysia that focuses on the labour market research and analytics. EU-ERA operates as a nucleus hub within The Future Studies Berhad (The Future). We are dedicated to conducting cutting-edge research and analysis on the rapidly changing economic and labor market landscapes, with the goal of informing policymakers, businesses, and the public about the implications of these changes.


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