Malaysia

The Malaysian economy slowed marginally in the first half (H1) of 2007, registering 5.6 percent GDP growth (y-o-y), down from 6 percent in H1 2006. This was mainly due to slower exports, which expanded only 2.5 percent relative to 6.2 percent in H1 2006. Growth was thus supported by private and government consumption, and by investment, which increased 10.8, 8.8 and 8.1 percent respectively. On the supply side, the services sector accelerated to 9.4 percent, underpinned by consumer spending, finance and insurance, and real estate. After two years of negative growth, output in mining and construction also picked up rather strongly in H1 2007. In contrast, agricultural and manufacturing outputs expanded at a much lower pace (0.6 and 1.8 percent respectively). Output in export-oriented industries contracted by 0.8 percent (5.1 percent for electrical and electronics products, E&E, alone), while output in domestic-oriented industries rose by 7.1 percent.

Exports in the first 7 months (7M) of 2007 increased only 1 percent to RM 334 billion (11.3 percent in 7M 2006). Although key agricultural exports expanded by 7.4 percent due to higher prices of crude palm oil and liquid natural gas, Electronics and Electrical exports, which accounted for nearly half of total exports, fell by 4.9 percent. This is partly attributed to weaker demand in the United States, which had nearly 20 percent of market share in 2006. Exports to the United States declined by 11.5 percent in H1 2007 relative to H1 2006. As gross imports rose by 3.4 percent, the trade balance in 7M 2007 was RM 51.7 billion, 10.4 percent lower than the same period last year. In the fourth quarter of 2006 and the first quarter of 2007, the current account surplus amounted to RM 27.9 billion, a 65.5 percent increase from the same period a year earlier, as the net balance on travel and investment income improved. Reflecting more favorable foreign direct investment and portfolio investment, the balance on capital and financial accounts also improved, recording a deficit of RM 20 billion from RM 46.7 billion in the earlier period. The overall deficit in the balance of payments therefore fell to RM 2.7 billion from RM 36.2 billion in the earlier period. Meanwhile, net international reserves rose steadily to RM 334.1 billion in August 2007, a 14.7 percent increase from August 2006.

Compared to H1 2006, federal government revenue rose by only 2 percent in H1 2007 due to much lower personal income tax revenue, although corporate income and petroleum income tax revenues increased. As both operating and development expenditures increased at significant rates (19.4 and 55.8 percent, respectively), government overall surplus fell to RM 974 million, a remarkable 91 percent lower than H1 2006. Higher operating expenditures included on emoluments, supplies and services, and grants and transfers, whilst development spending primarily involved agriculture and rural development, trade and industry, and transport. Meanwhile, the government debt increased to RM 260.1 billion at the end-Q2 2007, an 8.3 percent rise from end-Q2 2006.

The CPI inflation rate fell to 2 percent in the first 8 months (8M) of 2007 (8M 2006: 3.9 percent), as prices of most commodities and services increased only slightly. The Malaysian Ringgit continued to appreciate against the US dollar, although only moderately compared to other Asian currencies. At end-August 2007, the exchange rate was RM 3.50 per US dollar, appreciating from RM 3.53 and 3.78 at the end of 2006 and 2005, respectively. Monetary policy has been stable. The Overnight Policy Rate (OPR) is still kept at 3.5 percent since its last change in April 2006.

Based on the 3-month definition, the share of non-performing loans (NPLs) in total loans of the banking sector decreased from 4.8 percent in December 2006 to 3.6 percent in August 2007. The risk-weighted capital ratio, which reflects the degree of capital adequacy, stood at 13.3 percent in August 2007, which is a slight increase from end-2006. During this same period, the core capital ratio however dropped marginally. As for the stock market, the Kuala Lumpur

Composite Index (KLCI) fell rather heavily (7.3 percent) in August 2007 from July 2007 due to the worldwide financial turmoil led by the sub-prime loans crisis in the United States. The market has however rebounded since, and reached 1,369 as of 9 October 2007, which is about 25 percent up from end-2006.

Looking forward, real GDP growth in 2007 is expected to moderate to 5.7 percent, after growing 5.9 percent in 2006. Although export performance has so far been weak in 2007, domestic demand should help to sustain growth. Strong private consumption is likely, given favorable consumer sentiments, low inflation, high commodity prices, stable interest rates, and a recent pay hike for government officials. Similarly, an expansionary fiscal policy, following a recently announced government budget 2008, should also strengthen growth. The outlook for 2008 is more positive with a 5.9 percent growth rate. This prospect however depends largely on how significantly economic conditions in the United States worsen in the coming months. The sub-prime crisis appears to have had a limited effect on the Malaysian financial sector so, although its impact on export performance could be more significant over time.