

MALAYSIA

Real GDP in Malaysia grew by 6.3 percent in 2007, up from 5.9 percent in 2006. Growth was driven mainly by domestic demand, which offset slower goods and services exports growth. Private consumption jumped 11.7 percent driven by pay increases for government officials, stable interest rates, and favorable commodity prices. Public consumption also grew to 6.4 percent from 5.0 percent a year earlier. Gross investment finally started to recover after the 1997 crisis, reaching 10.2 percent in 2007—more than triple the annual average over the last 5 years. FDI rose by 54 percent, amounting to US\$9.4 billion in 2007. On the supply side, the growth was broad-based. The services sector continued to perform well (9.7 percent growth), and mining sector and construction rebounded after a few years of negative growth. Reflecting slowing exports, the manufacturing sector expanded only 3.1 percent, the slowest pace since 2001. Agricultural sector growth also slowed to 2.2 percent, mainly from sluggish rubber production.

The current account surplus remained high at 15 percent of GDP in 2007. Gross export growth slowed in 2007 to 2.7 percent, compared to an average of 12.1 percent during 2002–06. Electronic and electrical exports (E&E), which account for about 60 percent of total manufactured exports, decreased by 4.2 percent. Slowing E&E exports were partially offset by agricultural and commodity products that expanded 14.5 percent due mainly to higher commodity prices. Exports to the US dropped 14.5 percent in 2007. Exports to Singapore, which re-exports many Malaysian products to the US, also fell by 2.5 percent. Exports grew to China (24.3 percent), Japan (5.8 percent), and the EU (3.8 percent). The balance of payments position remains favorable with reserves rising by end-February 2008 to US\$116.1 billion—equivalent to 9.6 months of retained imports and 6.8 times the short-term external debt. Total external debt as a percentage of GDP continues to fall and was 31.3 percent for 2007.

Inflation began to show signs of rising in late 2007. Annual inflation for the year remained moderate at 2.7 percent, down from 3.6 percent in 2006. However, the monthly CPI for food and nonalcoholic beverages increased from 2.3 percent in June 2007 to 4.2 percent in February 2008 driven by high commodity prices. Furthermore, although fuel price subsidies were reduced in 2005 and 2006, subsidies were maintained in 2007, suggesting that further adjustment will be needed. The Malaysian Ringgit continued to appreciate against the US dollar. As of 26 March 2008, the Ringgit stood at RM 3.18 per US dollar, appreciating from RM 3.53 and 3.31 at the ends of June and December 2007, respectively. Compared to other East Asian currencies, Malaysia's real effective exchange rate has appreciated only modestly. Meanwhile, the key policy interest rate has been maintained at 3.5 percent since its last change in April 2006.

The fiscal deficit amounted to 3.2 percent in 2007, slightly below the 2006 level. Fiscal policy has been expansionary, with increases in spending for emoluments, agriculture and rural development, trade and industry, transport, education, and housing. Government is aware of the need for fiscal consolidation although the budget for 2008 leads to further fiscal expansion. Similar to the level at end-2006, federal government domestic debt in 2007 reached 42.3 percent, which is high relative to other East Asian countries.

The banking sector remains sound. Non-performing loans (NPLs) as a percentage of total loans decreased from 4.1 percent in June 2007 to 3.1 percent in January 2008. The risk-weighted capital ratio stood at 13.2 percent in January 2008, a slight decline from June 2007. There are no reports of Malaysian commercial banks affected by the US sub-prime mortgage crisis,

possibly because the rules that limit foreign investments were relaxed only recently. As for the stock market, the Kuala Lumpur Composite Index (KLCI) performed reasonably well in 2007, up from 1,096 at end-2006 to 1,445 at end-2007. However in 2008, it has retreated, especially after the announcement of general elections outcomes in which the government won many fewer parliamentary seats and states than expected. The index dropped 9.5 percent on March 10, 2008 alone.

Real GDP growth is projected to slow to 5.5 percent in 2008 before picking up to 5.9 percent in 2009. A sharp recovery in export performance is unlikely, given possible economic downturns in other large economies. Private consumption, which was Malaysia's growth engine last year, should continue to propel the economy, supported by recent government measures that seek to boost consumer spending. Although reduced subsidies had been widely expected before the elections, the government recently announced that prices of fuel, gas, and electricity will remain unchanged in the near-term future (that is, their price subsidies will not be cut). The fiscal deficit is projected to increase from 3.2 percent in 2007 to 3.5 percent in 2008. Downside risk factors to the growth projections include a deeper global economic slowdown, mounting inflationary pressure, and higher political uncertainty after the elections. Rising political uncertainty also might restrain private fixed investment, both domestic and foreign, which is needed to propel several mega projects in the economic corridors under the Ninth Malaysia Plan.