

MALAYSIA

GDP growth decelerated sharply in the first half of 2001, as reflected across a wide array of sectors apart from services. Before the 11 September attacks on the US, the decline in industrial production seemed to be bottoming out, but given weaker than expected recent US economic data, economic growth may decelerate further over the rest of the year. Significant public infrastructure spending in the 2001 budget and further pump-priming measures announced in September may boost GDP growth in early 2002.

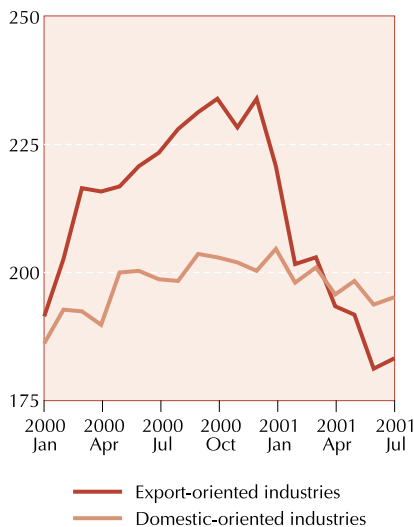
Economic Indicator (percent)	1998	1999	2000	2001		2002	
				Current	ADO 2001	Current	ADO 2001
GDP growth	-7.4	6.1	8.3	0.8	4.9	3.1	6.0
Inflation rate	5.3	2.8	1.5	1.7	2.6	2.0	2.8
Current account/GDP	13.2	15.9	9.4	5.2	5.5	4.7	3.2

Economic Assessment. The broad-based growth that began in 2000 decelerated sharply in the first half of 2001 on a year-on-year basis to 1.7 percent, from 9.7 percent in the second half of 2000. On the demand side, much of the slowdown is explained by the drop in exports of electrical and electronic products and the knock-on effect on private consumption and gross fixed investment. Given that Malaysia's ICT exports account for more than 60 percent of total exports and that the US is its second largest market after the DMCs, the faster deceleration in US growth than expected at the time of *ADO 2001* has led to worse than expected export performance. Although Malaysia is diversified both in its range of ICT exports and its direction of trade, the secular downturn has occurred across most exports. In addition, the assumption in *ADO 2001* that intraregional trade might provide some cushion against an external shock from interregional trade has not held, because about 40 percent of Malaysia's total imports are electronic parts and components. Of this amount, close to 45 percent come from DMCs. The import concentration of ICT products ranges from 15 to 50 percent across the PRC, NIEs, and Southeast Asia. In addition, the export concentration of ICT products to DMCs from these economies ranges from 20 to 45 percent. Hence, any shock to regional ICT sector performance is immediately transmitted through intraregional trade.

In terms of domestic demand, the expectation that the economy's diversity—consumption and investment account for roughly 36 percent and 20 percent of GDP, respectively—would mitigate any slowdown in exports has not held up that well either in the first half of 2001. Much of the high rates of fixed investment, which recorded a year-on-year increase of 24.1 percent in 2000, were in the ICT sector, contributing to a deceleration to 4.3 percent growth in the first half of 2001. Private consumption growth slowed to 2.9 percent in the first half of the year from 14.0 percent in the second half of 2000. Rising concerns about wage cuts and retrenchment, as reflected by a

The falloff in electrical and electronic products has strongly affected industry...

Seasonally adjusted industrial production index (1993 = 100)



Sources: Bank Negara Malaysia (July 2001) Monthly Statistical Bulletin, CEIC Data Company Ltd.

4.0 percent unemployment rate in the first quarter of 2001, from an average of 3.1 percent in 2000, explain much of the downturns in private consumption and the consumer sentiments index.

In response to weakening aggregate demand conditions, and because domestic demand conditions are intricately linked to the external sector, manufacturing activity, which accounts for 29.6 percent of GDP, contracted by 6.7 percent year on year in the second quarter of 2001. The services sector, which accounts for 49.1 percent of GDP, expanded by 6.2 percent over this period, after 3.2 percent growth in the first quarter, supported by resilience in the finance, insurance, real estate, and business subsectors on the back of low interest rates.

Price pressures remained subdued in the first half of 2001 with the CPI rising by 1.8 percent compared to the corresponding period of 2000. Weakening domestic demand and inventory correction were the major factors.

The trade surplus on a customs basis continued to narrow in the first and second quarters of 2001, reflecting the inadequate adjustment that imports have made to slowing demand conditions, in spite of severe falls in both capital and intermediate goods imports in the second quarter of 2001 of 11.2 percent and 11.0 percent, respectively, over the corresponding period of 2000. The trade surplus stood at RM12.5 billion in the second quarter of 2001 compared to RM13.3 billion in the previous quarter. The current account surplus widened from RM7.6 billion in the last quarter of 2000 to RM8.2 billion in the first quarter of 2001 due to a narrowing of the deficit in the services and income accounts, stemming from a large increase in freight charged and tourist inflows, as well as from lower dividend outflows from multinational corporations. The balance-of-payments deficit deteriorated in the first quarter of 2001 to RM10.3 billion from RM9.2 billion in the previous quarter. Much of the deterioration is on account of weakness in the capital account emanating from debt repayment, offshore asset acquisitions, and a rise in net external assets of domestic banks.

In response to the slowdown in global economic activity and negative repercussions for the economy, the Government has promoted public spending targeted at consumption and investment. Federal government expenditures rose by 43.4 percent and 59.1 percent in the fourth quarter of 2000 and the first quarter of 2001, respectively, although the impact on growth in the first half of this year seems limited. In August 2001, the Government announced a new fiscal package to be introduced in October's budget. In September, it stated that it would spend \$1.1 billion to stimulate the economy. The total stimulus package announced through September, including a \$790 million stimulus package of March 2001, was 2.3 percent of GDP. However, the effects of these measures are as yet unclear because only 6.7 percent of the March package has been spent. It is possible that the spin-off effects may be felt in the first half of next year, and may help support a modest recovery of domestic demand.

In September, the central bank cut the policy rate by 50 basis points to 5.0 percent, the first interest rate cut since August 1999. There is some room for monetary policy flexibility as external reserve positions have stabilized,

some further US dollar weakness may be evident, and global easing of interest rates continues.

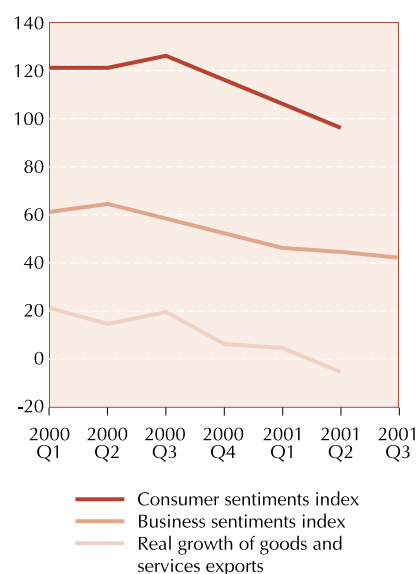
Economic Management Issues. In the short to medium term, Malaysia will remain affected by the cyclical nature of global ICT product demand, given its small economy. In particular, its current heavy reliance on exports of electronic parts and components may soon become a liability as lower-cost economies in Asia compete for market share of these low-end and low-skill products. As part of the Government’s fiscal stimulus package, improvements of technical skills and infrastructure in the ICT sector would help move the economy up to more sophisticated product lines where it may face less competition from regional rivals. In addition, regulations have to be devised to encourage local competition in the ICT sector and consolidation of weak firms. In the telecommunications sector, for example, where fixed-line services are still dominated by the state monopoly—Telekom Malaysia—weak wireless operators survive in spite of high debt loads, and network quality requires significant improvement.

Forecast. GDP growth forecasts for the remainder of 2001 and 2002 depend on the extent of the US economic recovery, the effect of ongoing domestic fiscal stimulus packages, the extent of the continuing inventory adjustment process in the country, and the timing of the pickup in new US orders for ICT products, which are highly correlated with Malaysian exports of ICT products. On this basis, GDP growth is forecast at 0.8 percent and 3.1 percent for the whole of 2001 and 2002, respectively.

Price pressures are expected to remain subdued for the rest of this year, while a slight rise in the CPI is expected next year as domestic demand conditions improve, suggesting increases of 1.7 percent and 2.0 percent, respectively, for 2001 and 2002.

The current account surplus is expected to narrow to 5.2 percent of GDP in 2001 due to the delayed downward adjustment of capital and intermediate goods imports, in spite of a significant contraction in manufacturing. In 2002, on the back of a solid pickup in manufacturing, a modest improvement in exports, and greater demand for inputs (which have a high import concentration), the current account surplus is expected to further narrow to 4.7 percent of GDP.

...while general sentiment turns gloomier



Sources: Bank Negara Malaysia (July 2001) Monthly Statistical Bulletin, CEIC Data Company Ltd.