

MALAYSIA

The economic recovery that began in 1999 has continued to both widen and deepen. Faster restructuring of heavily indebted corporate entities will enhance medium-term growth prospects.

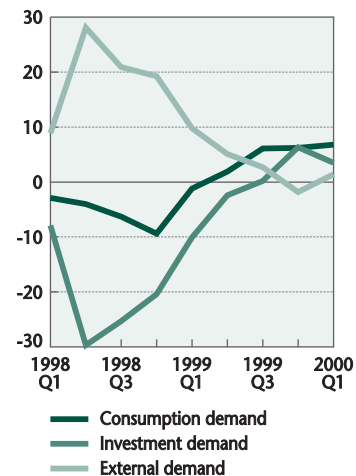
Economic Indicator (percent)	1997	1998	1999	2000	2001
GDP growth	7.5	-7.5	5.4	7.8	7.0
Inflation rate	2.7	5.3	2.8	2.2	2.8
Current account/GDP	-5.9	13.0	15.8	10.8	7.7

Economic Assessment. GDP growth registered a 10.3 percent year-on-year increase in the first half of 2000 compared with 5.4 percent growth for the whole of 1999 and a rate of contraction of 7.5 percent in 1998. Economic growth in 2000 has been supported by improved external demand for manufactured goods, especially electronic products and parts, buoyant domestic consumption demand, and an upturn in gross fixed investment. The continued recovery led to a decline in the rate of unemployment to 3.0 percent of the labor force in March 2000, from 3.4 percent in March 1999. On the aggregate supply side, higher growth was evident on a broad front and was led by the manufacturing sector. This was followed by a strong rebound in the service sector owing to the overall improvement in economic performance and a turnaround in construction activity due to increased public spending on physical infrastructure and housing. Available data for the first half of the year indicate that private consumer demand has become more important relative to public consumption in promoting economic growth. However, public investment still remains the driving force behind the rise in gross fixed investment.

After averaging 2.8 percent in 1999, year-on-year consumer price inflation dropped steadily during the first seven months of 2000 to average 1.5 percent. The slowdown reflects both ongoing excess production capacity and lower food prices that continue to offset higher oil prices. Trade data for the first four months of 2000 indicate robust export growth and even stronger import growth. As a result, Malaysia's trade surplus narrowed to a still sizeable \$5.2 billion in January to April 2000, compared with a surplus of \$5.8 billion in the first four months of 1999. Surpluses on the trade account helped increase external reserves to \$34.0 billion at the end of June 2000, from \$30.9 billion at the end of December 1999.

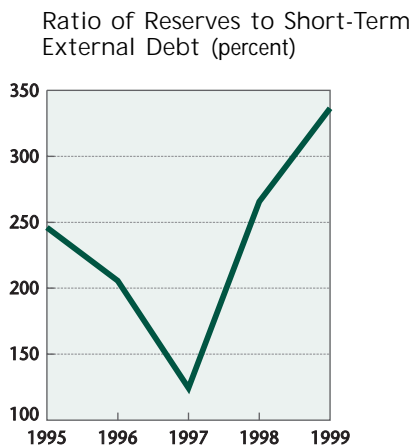
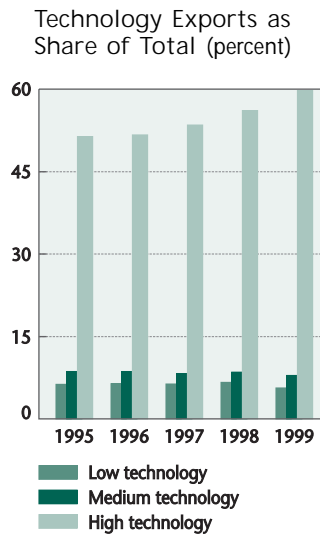
Although the Government remains committed to an expansionary fiscal policy, continuing economic recovery means that fiscal policy is likely to be less stimulative as tax revenues increase. With inflationary pressures expected to remain subdued, the Government is likely to continue with an accommodative monetary policy stance, maintaining low interest rates and its fixed exchange rate regime. As the currencies of Malaysia's main trading partners have strengthened since their crisis-induced lows, the ringgit has remained relatively undervalued. While this is providing a boost to manufactured exports, it may discourage

Decomposition of GDP Growth by Quarter (percent)



capacity restructuring and the emergence of productivity gains in the economy.

Structural Issues. Malaysia has made considerable progress in corporate and financial sector restructuring. Danaharta, the agency set up to purchase and rehabilitate the banking sector's bad debts, has completed its acquisition of nonperforming loans, and is well on the way to restructuring and disposing of assets under its management. Danamodal, the special-purpose organization for recapitalizing and strengthening banks, has injected a total of RM7.6 billion into 10 troubled banks since it was created in August 1998. While five financial institutions have already repaid their loans in full, the organization hopes to dispose of its stake in the remaining five by the end of 2000. These developments have led to a steady increase in loan approvals and disbursements during the first six months of this year. The Corporate Debt Restructuring Committee, which oversees voluntary corporate debt workouts, also restructured debts of 25 companies worth RM18.35 billion as of 26 June 2000. However, corporate issues remain unresolved. Many Malaysian firms remain heavily indebted and are unable to service their debt obligations. The Government continues to support firms which it considers strategically important. This is preventing an early resolution to corporate sector indebtedness. Restrictions on foreign ownership have also played a role in Malaysia's failure to benefit from the mergers and acquisitions that have become increasingly important as a source of regional FDI since the Asian financial crisis.



Forecast. Strong economic growth in the first half of 2000 has led to a revision of forecast growth upward from 6.0 percent to 7.8 percent for 2000, and from 6.1 to 7.0 percent for 2001. Enhanced private consumption growth will reduce excess industrial capacity and provide more incentives for fixed investment. During the remainder of 2000, purchasing power will recover further as unemployment eases, and fixed investment will pick up owing to increased bank lending. The rate of economic growth is likely to moderate in 2001 as fiscal policy becomes less stimulative as a result of increased tax revenues and as the contribution of net exports to growth is reduced by rising imports. Consumer price inflation is likely to increase during the remainder of the forecast period and average 2.2 percent in 2000 and 2.8 percent in 2001 as stronger domestic demand, due in part to higher real wages, is reinforced by higher oil prices.

The robust US and regional demand for Malaysia's electronic and electrical goods is likely to be accompanied by even faster import growth, due both to the import-dependent nature of exports and to higher demand for capital goods. As a result, the trade surplus will steadily narrow. This is likely to be reinforced by a further deterioration in the service and income deficits owing to Malaysia's dependence on imports of trade-related services and increased outflows of profit and dividend payments. As a result, the current account surplus will steadily narrow from 15.8 percent of GDP in 1999 to 10.8 percent of GDP in 2000 and 7.7 percent in 2001.